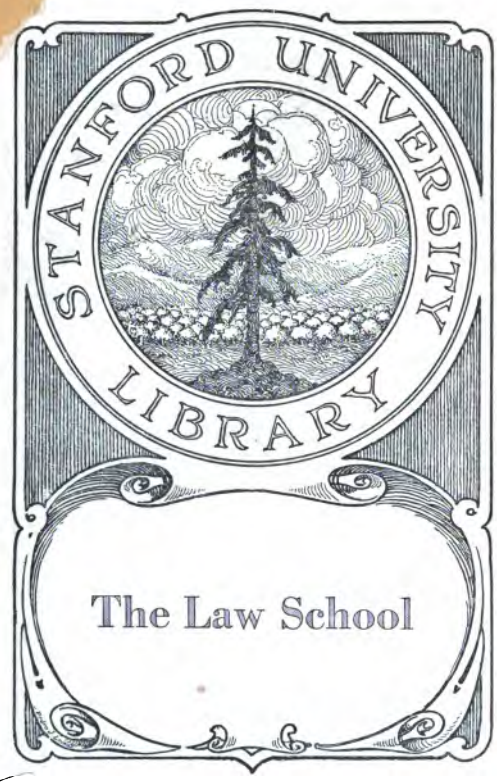
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A TREATISE

ON

SECRET LIENS

AND

REPUTED OWNERSHIP

BY

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OF THE NEW YORK BAR

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PREFACE.

The extended use of credit incident to modern business methods has directed the attention of the lawyer, banker and merchant to the rules of law which govern the giving of security by placing upon personal property liens which are not made public. The secret lien is generally based upon the very natural desire of the borrower to secure funds on specific property, without undergoing the injury to his credit standing which would result from such a transaction becoming a matter of public knowledge.

While it has been well said that "the fewer secret trusts or liens there are the better" and "secret liens are to be discouraged," yet the attempt of the business man of the present to make the most out of existing credit conditions tends to increase the number of such transactions. Interest in the rules of law governing these cases is not confined to the parties immediately involved in the transaction, but extends to all givers of credit. Transactions which may be good *inter partes* are frequently void as against general creditors, and it is in the conflict between the unsecured creditors and the secured creditor that the question is generally brought before the courts.

An effort has been made to sketch the historical development of the law upon this subject through the English statutes and decisions to the American decisions.

Without attempting to give the prevailing rules of law in each state, we have tried to show the development of the principles which govern the application of the rules of law to secret liens in both the federal and

state courts. Particular classes of cases which are of not unfrequent occurrence have been discussed, such as floating charges in mortgages, consignments of merchandise and trust receipts and the more recent efforts of individuals seeking through a corporation to put themselves forward freed from the disability which attached to the individuals composing the corporation.

The distinction between the doctrine of reputed ownership and fraudulent conveyances is pointed out. The increasing practical importance of the questions which are discussed and the comparative absence of legal writing upon the subject have led to the preparation of this treatise.

New York City, April, 1910.

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CHAPTER I.

THE ENGLISH STATUTE OF REPUTED OWNERSHIP, ITS BASIS AND ITS DIFFERENCE FROM THE STATUTE OF FRAUDULENT CONVEYANCES.

§ 1. Scope of the subject.

The disposition made by an insolvent person of his property, with the intention to deprive his creditors of the right to satisfy their claims therefrom, is usually described as a fraudulent conveyance. The rules governing the cases hereafter to be discussed, however, do not belong to the law of fraudulent conveyances, as that term should properly be used. For a fraudulent conveyance, in the proper sense, is one which was originally condemned under the Statute of 13 Elizabeth (ch. 5) commonly known as the Statute of Fraudulent Conveyances. The transactions affected by this early statute, as it now exists in England, and by re-enactment or adoption in the various States of our country, are conveyances made by a debtor with the intention of placing his property beyond the reach of the creditors whose claims existed at that time. It did not prohibit arrangements which, though not harmful to the interests of the then existing creditors of the debtor, yet were intended to place his property beyond the reach of such persons as might subsequently become creditors upon the mistaken supposition that the property was still his own. In the succeeding chapters are discussed the right of creditors in such cases as this to treat the property, despite the delusive appearance of ownership, as though it actually belonged to the insolvent.

§ 2. **In England covered by statute — In America left to a general principle.**

This right in England was early conferred by statute in cases of bankruptcy. We have never had such a National statute, nor have any of our States enjoyed the benefit of the English statute, either through its adoption or re-enactment.[1] In any such case in this country the rights of the deluded creditors must be enforced through the medium of some general principle. It is believed that the applicable rule may be found in the doctrine of equitable estoppel.

§ 3. **The Statute of Fraudulent Conveyances.**

Before further referring to the English statute, or the cases illustrating the equity principle which forms, with us, so efficient a substitute, it would be well to glance at the Statute of Fraudulent Conveyances. This, from an historical point of view, was the true predecessor of the latter statute, and so bears upon the present discussion.

§ 4. **Its origin.**

The Statute of Fraudulent Conveyances was passed in 1570 in the thirteenth year of Queen Elizabeth's reign. It was significant of the broadening scope of English commerce. The deadly grapple in the Low Countries between Orange and Spain greatly added to the tide of commercialism which already had set toward English shores. Indeed, it was not many years later that English goods found their way into the magazines even of the army of Parma, though that Prince's troops were then being drilled in embarka-

[1] 21 Jac. 1, ch. 19, §§ 10, 11 (1623).

tion for a projected descent upon the Kentish coast, just as, over two centuries later, in popular tradition, the Emperor Napoleon's troops during the winter campaign of Eylau were warmed by overcoats from the Yorkshire mills.

§ 5. **The evils at which it aimed.**

The practices at which the Statute aimed are pictured in its preamble as the "feigned, covinous and fraudulent feoffments, gifts, grants, alienations, conveyances, bonds, suits, judgments, and executions, more commonly used and practised in these days than hath been seen or heard of heretofore." And the draftsman of the statute proceeds to state that, in the opinion of the enacting power, if these evils of modern growth were not stopped, they would cause "the overthrow of all true and plain dealing, bargaining, and chevisance between man and man, without the which no commonwealth or civil society can be maintained or continued."

§ 6. **Its thesis — Possession indicates ownership.**

The thesis of the statute, as this preamble discloses, is that the possession of property is a good indication of ownership. Thirty-two years after the adoption of the Act *Twyne's case*[2] judicially established the proposition. This celebrated decision, inextricably mixed though it may be with Lord Coke's gloss, has become practically a part of the statute itself, and no mention of the latter would be complete without reference to the learned commentator's report of the result reached by the Queen's Bench.

[2] Coke's Rep. Part III, 80b.

§ 7. Twyne's case.

Twyne was prosecuted under the criminal clause of the statute, which, in this double aspect, resembles the typical modern anti-trust act. It appeared that one Pierce, being greatly indebted, made a general deed of gift of all his personal property to Twyne, but, nonetheless, continued in possession of the bargained property, and dealt with it as his own. Part of this property consisted of sheep, and, shearing time later approaching, the covinous Pierce shore the sheep and marked them as his own. Afterward a judgment creditor of Pierce attempted to take the sheep, but Twyne resisted the sheriff, claiming the goods so vociferously that presently he was laid by the heels in the Star Chamber. The court[3] held that the gift was fraudulent and within the statute.

§ 8. Twyne's case — Possession a badge of fraud.

Among the points resolved in this case, one seems of importance to the present discussion. This placed among the " signs or marks " or " badges " of fraud, the donor's continuance in possession of the goods. This is, in fact, the salient feature of Twyne's case. That possession by the grantor is a badge of fraud, became, and to this day remains, axiomatic. Whether it invokes in the given case a conclusive presumption against the grantor was for quite a while the subject of earnest discussion, which it is not necessary here to describe. The rule which finally became established was as stated by Burnett, J., in *Ryall* v. *Rowles*,[4] that " Possession is no otherwise a badge of fraud, unless

[3] Sir Thomas Egerton, Lord Keeper, Popham, C. J., and Anderson, J. and the whole Court of Star Chamber.

[4] 1 Ves., Sr., 348, 360.

as calculated to deceive creditors."[5] But its importance was never lost sight of. The English judges, whether on common law bench, or Chancery Woolsack, steadily kept before them the sound principle stated by the same learned judge above quoted that "*there is no* (and here we would add, *more obvious*) way of coming at the knowledge of who is owner of goods, but by seeing in whose possession they are."[6] The only recorded dissent from this view was once expressed by Parke, B., in the course of a colloquy with counsel.[7] But the dissent of the learned Baron however great his reputation in the fields of special pleading, can scarcely tip the scales against the contrary views of the numerous judges — English, Irish and American — embodied in the decisions, ancient and modern, with which this discussion is concerned.

It was not, indeed, so very long ago that our Supreme Court emphatically declared that "men get credit for what they apparently own and possess."[8]

§ 9. The corollary — Possession presumptively begets credit.

As the possession of property is, to the judicial mind a fair indication of its ownership, it is equally true, as a proposition founded upon human experience, that the possession of property presumptively begets credit. The decisions under the Statute of Fraudulent Conveyances did not directly result from this latter proposition, because the scope of inquiry in any case under that statute did not include the rights

[5] *Lady Arundel* v. *Phipps,* 10 Ves. 139; *Ex parte Williams,* 11 Ves. 3; *Ex Parte Martin,* 19 Ves. 491; *Martindale* v. *Booth,* 3 B. & Ad. 498; *Joy* v. *Campbell,* 1 Sch. & Lef. 328.

[6] Burnet, J., in *Ryall* v. *Rowles,* 1 Ves. 348, 360.

[7] *Whitfield* v. *Brand,* M. & W. 282.

[8] *Robinson* v. *Elliott,* 22 Wall. 513, 525.

of subsequent creditors. No case could properly arise under the Statute of Fraudulent Conveyances, except where creditors existing at the time of the transaction had been defrauded by the removal of the debtor's property. If, on the contrary, the debtor had, indeed, placed the title of his property in another, but had continued in possession to the wrong, not of any creditors whose claims then existed, but of persons who subsequently became his creditors in the belief that he owned the property of which he stood possessed, the case was not within the Statute of Elizabeth. Yet a modern lawyer would have no difficulty in pronouncing this as a clear case of estoppel. Had there been, when such cases first arose, a Court of Chancery in the full vigor of its jurisdiction, as in the time of Sir George Jessel, or even in the period of his great predecessor, Lord Hardwicke, the matter could have safely been left to the capacities of what the former of these judges has fitly styled "the gradual growth of equity."[9] But about the time when, according to its preamble, the evils pressed against which was aimed the Statute of James to be mentioned, the Court of Chancery was in the thick of its grievous struggle with the King's Bench. With many of the bar fervently against it, how could the Court of the Great Seal ask the merchant public to leave such matters to the wisdom of its Chancellors and the plasticity of its process?

§ 10. The result — The Statute of Reputed Ownership.

So to Parliament the creditor class again went for relief, and the result was the Statute of James,[10]

[9] *In re Hallett's Estate,* 13 Ch. Div. 696.

[10] 21 Jac. 1, Ch. 19, §§ 10, 11.

which to-day, in its essential features, appears in the present English Bankrupt Act.[11] The "reputed ownership clause" of the Jacobean Statute was as follows:

> "And for that it often falls out, that many persons before they become bankrupts do convey their goods to other men upon good consideration, yet still do keep the same, and are reputed the owners thereof, and dispose of the same as their own, be it enacted, that if at any time hereafter, any person or persons shall become bankrupt, and at such time as they shall so become bankrupt, shall by the consent and permission of the true owner and proprietary, have in their possession, order, and disposition, any goods or chattels, whereof they shall be reputed owners; and take upon themselves the sale, alteration, or disposition as owners, that in every such case such goods shall be liable to the bankrupt's debts, as if they had been the proper goods of the bankrupt."

§ 11. This statute the remedy for subsequent creditors in England.

To this Statute of James did the English judges remit cases of the kind just described, which lay without the province of the Statute of Elizabeth and were not, technically speaking, fraudulent conveyances. As we have said, the final construction placed upon the latter statute by the English courts precluded its application to subsequent creditors.

That rule, first enunciated in *Shaw* v. *Standish*,[12] received its final impress in *Glaister* v. *Hewer*.[13] The

[11] Bankrupt Act of 1883 and 1890, § 44.

[12] 2 Vern. 326.

[13] 8 Ves. 199.

rights of subsequent creditors, as the courts viewed it, must be adjusted under the Statute of Reputed Ownership. This is apparent from the language used by Lord Hardwicke in *Taylor* v. *Jones,*[14] and the result reached in *Glaister* v. *Hewer.*[15] In the latter case Lord Eldon reversed a decree of Sir William Grant, M.R., dismissing a creditor's bill on the ground that, while the Master of the Rolls was right in holding that subsequent creditors could not place their rights within the Elizabethan Statute of Fraudulent Conveyances, yet they were protected, in the proper case, of which the one at bar was an instance, by King James' Statute of Reputed Ownership. This conclusion was adopted, at an early date, by the Supreme Court of the United States.[16] There can nowadays be no doubt of the proposition of Sir John Leach, M.R.,[17] there approved,[18] that "A voluntary conveyance, by a person not indebted, is clearly good against future creditors." That, as the Master of the Rolls says, " constitutes the difference between the two statutes."

§ 12. The estoppel principle the American substitute for subsequent creditors.

In this country we have only one of the two statutes mentioned by Sir John Leach, viz.: the Statute of Fraudulent Conveyances. Consequently, the rights of subsequent creditors, with us, are in all cases left to the doctrine of estoppel. The present American rule has thus been stated in *Todd* v. *Nelson:*[19]

[14] 2 Atk. 600.
[15] 8 Ves. 199.
[16] *Sexton* v. *Wheaton,* 8 Wh. 229.
[17] *Battersbee* v. *Farringdon,* 1 Swanst. 106.
[18] 8 Wh. at p. 249.
[19] 109 N. Y. 316, 327.

"The theory upon which deeds conveying the property of an individual to some third party have been set aside as fraudulent in regard to subsequent creditors of the grantor has been that he has made a secret conveyance of his property while remaining in the possession and seeming ownership thereof, and has obtained credit thereby, while embarking in some hazardous business requiring such credit, or the debts which he has incurred were incurred soon after the conveyance, thus making the fraudulent intent a natural and almost necessary inference, and in this way he has been enabled to obtain the property of others who were relying upon an appearance which was wholly delusive. Such are the cases cited by the learned counsel for the appellants."[20]

§ 13. **A preliminary review necessary.**

Before, however, taking up the application of the estoppel principle to the cases contemplated by the framers of the Statute of Reputed Ownership we shall first discuss the history of this statute in the land of its enactment and its absence from the legislative annals of our country.

[20] This language is cited with approval by the Supreme Court in *Schreyer* v. *Scott*, 134 U. S. 405, 409, 10 Sup. Ct. Rep. 579.

CHAPTER II.

THE LATTER DAY ASPECTS OF THE STATUTE IN ENGLAND.

§ 14. The present English statute.

The Statute of Reputed Ownership as enacted in the time of King James appeared in every successive English bankrupt law. It appears to-day in section 44 of the Bankrupt Act of 1883:[1]

> "The property of the bankrupt divisible amongst his creditors and in this act referred to as the property of the bankrupt * * * shall comprise the following particulars * * *. All goods being at the commencement of the bankruptcy in the possession, order or disposition of the bankrupt in his trade or business, by the consent and permission of the true owner under such circumstances that he is the reputed owner thereof; provided that things in action other than debts due or growing due to the bankrupt in the course of his trade or business, shall not be deemed goods within the meaning of this section."

In the previous General Bankrupt Act of 1869 the language of the corresponding section[2] is the same except that the words "in his trade or business" are substituted for "being a trader" and the words "under such circumstances that he is the reputed owner thereof" for "of which goods the bankrupt is reputed owner or of which he has taken upon himself the sale or disposition as owner." And in the

[1] 46 and 47 Vict., Ch. 52.

[2] § 15, subd. 5.

proviso at the end of the section "debts due or growing due" is substituted for "debts due."[3]

§ 15. The limitations of the present Act.

The early English bankrupt statutes related solely to traders, and the Reputed Ownership clause consequently applied to the ostentation of ownership only when it appeared in the course of trade. Persons who were not traders were excluded from the benefits or burdens of bankruptcy until the adoption of the Bankrupt Act of 1861, which preceded the Act of 1869, above mentioned. This exemption carried with it to the cases of nontraders the Reputed Ownership clause, the original Statute of James having in successive periods of legislation finally become a clause of the General Bankrupt Statutes. But the consolidation of the existing bankrupt laws, resulting in the General Bankrupt Act of 1869 and its successor the present Act of 1883, as amended by the Act of 1890, while continuing to admit nontraders to bankruptcy limited the Reputed Ownership clause to the cases of traders. The existing Act of 1883, as will be noticed from the passage above quoted, extends the doctrine of reputed ownership only to property "in the possession, order or disposition of the bankrupt in his trade or business."

§ 16. The absence of such provisions from the Insolvent Debtors' Acts.

Prior to the Act of 1861 an insolvent non-trader could obtain relief from his debts only under the insolvent debtor's acts, which were adopted to ameliorate the horrors of what otherwise in so many cases would amount to perpetual imprisonment for

[3] Williams on Bankruptcy, 8th ed., p. 217.

debt. But as Lord Fitzgerald has pointed out in his graphic opinion in *Colonial Bank* v. *Whinney,*[4] in none of these acts does the Reputed Ownership clause appear.

§ 17. **The reasons for this — First:**

The probable reason for this was twofold:

First, and of more importance from our point of view, since with us the rights which the statute attempted to adjust are left to the more flexible operations of the doctrines of equity, was the idea that the representation could naturally occur only in the course of trade. When a trader is not engaged in a business which involves the carrying of a stock of goods or merchandise, credit is not so apt to be given on the faith of his mere possession of property. The cases in which deceit can be practiced other than by means of the possession of goods have practically been limited in the experience of our courts to cases where deeds of real estate have been withheld from record. But the kind of deceit with which we are concerned is of more frequent occurrence with a trader. In his case the possession of goods, under such circumstances that they would appear to be his, is the more apt to produce an extension of credit in his behalf.

§ 18. **The reasons — Second:**

The second reason was doubtless a reaction from two shockingly unjust results which the common law courts had reached in the interpretation of this statute: (1) It was immaterial to the operation of the statute whether the creditors extended credit before or after the ostentation of ownership was effected; (2) the true owner could, with impunity, remove the

[4] 11 A. C. at pp. 443, 445.

goods at any time prior to the bankruptcy, however credit may have been extended on the faith of the bankrupt's apparent ownership.[5]

§ 19. The misfortune of this result.

This result is remarkable in view of the indubitable fact that this statute really was an attempt at a legislative expression of a true doctrine of equity. As has been said, it is "a rough approach to that justice which is meted out by the law of estoppel."[6] An eminent equity judge once characterized the statute as "probably the only instance of our law in which not only purposely but avowedly the property of one man is laid hold of to answer the debt of another."[7] But an equally distinguished authority on our side of the water has emphatically stated that "the principle of that law is just."[8] Properly construed, the act indeed took the property of one and applied it to the debts of another, but only in accordance with the spirit of its framing, which was the idea of equitable estoppel. And even by a civilian writer we find this law described as resting on "a natural ground of justice."[9] It is unfortunate, therefore, that this statute, so beneficent in its purposes, should, merely because of its crudeness of expression, have received such a construction at common law hands as to make the English legislators chary of its application to other than its original field. Doubtless this was the

[5] *Young* v. *Hope,* 2 Ex. 105; Ewart on Estoppel, pp. 300–301.

[6] Ewart on Estoppel, 301.

[7] Christian, L. J. *In re Hickey,* 10 Irish Rep. Eq. 129.

[8] Mr. Justice Bradley in *Frelinghuysen* v. *Nugent,* 36 Fed. 237.

[9] Bell's Principles, § 1315; Goudy on Bankruptcy (Scotch), 3d ed., p. 323.

inducement for Parliament to withhold the clause from the winding up portions of the Companies Acts as first enacted and as successively amended.[10] The statute expressed a principle of equity, but, unfortunately, its application was not confined to the equity judges. Its history, indeed, presents the remarkable instance of the common law courts so interpreting a statute as to render it harsh, and then roundly condemning it for the attributes thus imposed.[11]

§ 20. The present statutory law in England.

Thus at present in England we find the Reputed Ownership clause occupying exactly the same position that it did at the time of its enactment. Then it was part of a Bankrupt Act which applied only to traders. Now, though part of a Bankrupt Act, applying to nontraders as well as traders, it is specially restricted to the cases of traders. Then there were no statutory provisions for the winding up of incorporated companies. Now, though that subject is completely covered by the winding up provisions of the Companies Acts, the Reputed Ownership clause is conspicuous by its absence. In its restricted field it is given effect, but the judges of modern times have applied it with a more enlightened idea of its value. A clear description of its present field of usefulness

[10] See *In re Crumlin Viaduct Co.*, 11 Ch. Div. 755; *Gorringe* v. *Irwell Rubber Co.*, 34 Ch. Div. 128.

[11] *Young* v. *Hope*, 2 Ex. 105; *Prismall* v. *Lovegrove*, 6 L. T. (N. S.) 329; *Whitfield* v. *Brand*, 16 M. & W. 282. See the Judgment of Lord Blackburn in *Colonial Bank* v. *Whinney*, 11 A. C. 426, 436.

is thus given by Lord Selborne, L. C., in *Ex parte Watkins*:[12]

> "I should not like to commit myself to the strong language of Sir Frederick Pollock in the case of *Prismall* v. *Lovegrove,* in which he said that the old doctrine of reputed ownership was completely out of fashion and had been so for at least forty years. It would be more in accordance with my opinion to say that the doctrine of reputed ownership has been the same from first to last, but that the courts have of late years looked more narrowly and closely to the real weight and value of the facts which tend on the one hand to confirm and on the other hand to exclude the representation of ownership."

[12] L. R. 8 Ch. App. 520, 532.

CHAPTER III.

REPUTED OWNERSHIP IN AMERICA — THE ABSENCE OF FEDERAL LEGISLATION.

§ 21. No reputed ownership clause in the National Bankrupt Acts.

In all, since the foundation of our Federal government, we have had four National Bankrupt Acts, including the present Act of 1898.[1] In none of them are provisions similar to the English Reputed Ownership Statute previously discussed.

§ 22. Clauses apparently of that nature.

A first reading indeed, of the present Bankrupt Act would not seem to support this assertion. It vests[2] the trustee with the title to all property of the bankrupt "which, prior to the filing of the petition, he could by any means have transferred, or which might have been levied upon and sold under judicial process against him." And the same statute[3] renders void as against the trustee, "claims which, for want of record or other reasons, would not have been valid liens as against the claims of the creditors of the bankrupt."

§ 23. Their interpretation — Erroneous view.

Naturally these two provisions, unparalleled in the earlier Bankrupt Acts of our country, at first caused considerable divergence of opinion among the different Federal Circuits. In some the idea was entertained that the trustee under the present act is vested with the status of an innocent purchaser for value[4]

[1] Bankruptcy Acts of 1800, 1841, 1867, 1898.

[2] § 70-a-5.

[3] § 67-a.

[4] *In re Booth*, 98 Fed. 975, 3 Am. B. R. 574.

and that, accordingly, an unrecorded mortgage made by the bankrupt, though valid by the State law against general or judgment creditors, is void as against the trustee.[5]

§ 24. **Their interpretation — The prevailing view.**

But the statute was destined for no such broad interpretation. The contrary view enunciated in the Second Circuit[6] has prevailed; and the Supreme Court, by a series of considered judgments, has established the effect of these statutory provisions as vesting the trustee with no rights other than those of the bankrupt, as against the latter's grantees and privies, except in these three classes of cases:

1. Cases of transactions in fraud of creditors.
2. Cases of preferences made void by the Bankrupt Act.
3. Cases of conveyances or obligations to which the bankrupt was a party, which, under the State statutes having application in the premises by reason of the location of the subject matter, are void or voidable as against the creditors of the bankrupt.[7]

[5] *In re Lukens,* 138 Fed. 188, 14 Am. B. R. 683; *In re Thorp,* 130 Fed. 371, 12 Am. B. R. 195; *In re Pekin Plow Co.,* 112 Fed. 308, 7 Am. B. R. 369; *English* v. *Ross,* 140 Fed. 630, 15 Am. B. R. 370.

[6] *In re Economical Printing Co.,* 110 Fed. 514, 6 Am. B. R. 615.

[7] *Hewitt* v. *Berlin Machine Works,* 194 U. S. 296, 24 Sup. Ct. Rep. 690; *Thompson* v. *Fairbanks,* 196 U. S. 516, 25 Sup. Ct. Rep. 306; *Humphrey* v. *Tatman,* 198 U. S. 91, 25 Sup. Ct. Rep. 567; *York Mfg. Co.* v. *Cassell,* 201 U. S. 344, 26 Sup. Ct. Rep. 481; *Security Warehousing Co.* v. *Hand,* 206 U. S. 415, 27 Sup. Ct. Rep. 720; *Bryant* v. *Swofford Dry Goods Co.,* 214 U. S. 279, 29 Sup. Ct. Rep. 614. A discussion of this subject will be found in an article in the Columbia Law Review, vol. 6, at p. 562.

§ 25. **The Federal Courts follow the local law.**

It had long been the rule that in determining the validity of mortgages, pledges, or other arrangements for the title or possession of property, whether real or personal, as against the creditors of the mortgagor, pledgor, or grantor, the Federal Courts would follow the law of the State where the property in question was situated.[8] On the other hand, it was so well established, under all the previous Bankrupt Acts of both England and this country, that the trustee in bankruptcy, or the Chancery receiver appointed on creditors' bill, foreclosure proceedings, or the like, is vested with all the rights which the creditors of the insolvent would have had in the absence of the bankruptcy or the receivership, that *Yeatman* v. *Savings Inst.*[9] where, in effect, the contrary was held, is hard to understand. It is believed that the intent of the framers of the previously mentioned sections of the present Bankrupt Act was merely to restore the law to what it was generally understood to be prior to the *Yeatman case*.[10]

§ 26. **The summary.**

It is, then, at present, true, first, that the National Bankrupt Act contains no reputed ownership clause, and, second, that, in the Federal Courts, the validity or invalidity as against creditors, of arrangements respecting the title to real or personal property, is a

[8] *Ethridge* v. *Sperry,* 139 U. S. 266, 11 Sup. Ct. Rep. 563; *Dooley* v. *Pease,* 180 U. S. 126, 21 Sup. Ct. Rep. 308; *Bamberger* v. *Schoolfield,* 160 U. S. 149, 16 Sup. Ct. Rep. 225; *Hartford Ins. Co.* v. *Chi., etc., Ry. Co.,* 175 U. S. 91, 20 Sup. Ct. Rep. 225.

[9] 95 U. S. 764.

[10] See article in vol. 6, Columbia Law Review, p. 562.

question of "local law," that is, the law of the State where the property affected is situated.

§ 27. Recent decisions on the supremacy of local law.

The second of the propositions last stated has been made very clear by recent decisions of the Supreme Court. Prior to this, however, it was not quite certain just how far the self-imposed rule of loyalty to local law would govern the Federal Courts in these cases. In *Warren* v. *Moody*[11] the courts seemed to disregard the law of Alabama where the property was situated and the transaction occurred respecting the validity of a conveyance under the Statute of Fraudulent Conveyances. At a somewhat later date we find the court stating that in any such case the local law should be given very great consideration. But these statements by no means seem to amount to a self-denying ordinance.[12] In *Ethridge* v. *Sperry*,[13] however, the court laid down the principal that all questions of the validity of transactions respecting a debtor's property as against the latter's creditors should be one of local law entirely. And later this doctrine was again announced.[14] It was not, however, until after the adoption of the Bankrupt Act of 1898 that the court finally committed itself to this proposition.[15]

[11] 122 U. S. 132, 7 Sup. Ct. Rep. 1063.

[12] *Schreyer* v. *Scott*, 134 U. S. 405, 409, 10 Sup. Ct. Rep. 579; *Randolph* v. *Quidnick Co.*, 135 U. S. 457, 10 Sup. Ct. Rep. 655.

[13] 139 U. S. 266, 11 Sup. Ct. Rep. 563.

[14] *Bamberger* v. *Schoolfield*, 160 U. S. 149, 16 Sup. Ct. Rep. 225; *Hartford Ins. Co.* v. *Chicago, etc., Ry. Co.*, 175 U. S. 91, 20 Sup. Ct. Rep. 33.

[15] *Hewitt* v. *Berlin Machine Works*, 194 U. S. 296, 24 Sup. Ct. Rep. 690; *Thompson* v. *Fairbanks*, 196 U. S. 516, 25 Sup. Ct. Rep.

§ 28. Qualifications of this idea of supremacy.

In determining the local law in a given case, however, the Federal Courts are often, in effect, compelled to make law for themselves. If the courts of the State whose law is under search have failed to pronounce what that law is, then the Federal Courts are free to follow their own views.[16] And even where the State law is clearly apparent, there are frequent instances of the Federal Courts, though applying that law, yet really making it a standard for their own future guidance. An illustration is afforded by the two cases of *Casey* v. *Cavaroc*,[17] and *In re Marine, etc., Co.*[18] In *Casey* v. *Cavaroc* it was held that possession by the pledgee is essential to the validity of a pledge as against the pledgor's creditors. The question was one of Louisiana law, by which it was clear that possession by the pledgee was necessary. But the judgment of the court, as pronounced by Mr. Justice Bradley, was far from a slavish statement of the law of the particular forum in whose making he had no hand. Instead, so clearly did he vindicate the soundness of the local rule which he applied, that he himself made it the law for the other independent forums embraced within this nation, for since then many have followed his reasoning, and none dissented. On the other hand, the Circuit Court of Appeals, Second Circuit, in holding the "after-

306; *Humphrey* v. *Tatman*, 198 U. S. 91, 25 Sup. Ct. Rep. 567; *Bryant* v. *Swofford Dry Goods Co.*, 214 U. S. 279, 29 Sup. Ct. Rep. 614; *In re Marine, etc., Dry Dock Co.*, 144 Fed. 649, 14 Am. B. R. 466; *Walther* v. *Williams Mer. Co.*, 169 Fed. 270, 22 Am. B. R. 328.

[16] *Burgess* v. *Seligman*, 107 U. S. 20, 2 Sup. Ct. Rep. 10.

[17] 96 U. S. 467.

[18] 144 Fed. 649, 14 Am. B. R. 466.

acquired clause" of a mortgage void as against the mortgagor's creditors, contented itself with stating and following the local law, which was of New York, but which, in fact, coincided with the views which the Supreme Court had already expressed in cases where it had a free hand.[19] Also, it must be observed that, in many instances, the Federal Courts, even the highest, have not been wholly consistent in dealing with cases where the local law applies. A striking instance of this occasional impatience is afforded by that celebrated case where, in a question of this sort, the local law had been declared and should have been applied. Yet to the dictum of the court, directly to the contrary, the profession is indebted for the classic which it provoked. To Mr. Justice Miller's bold declarations in *Nicolls* v. *Eaton*,[20] we owe Gray's profound treatise on Restraints on Alienation.[21] Confusion only would result, it is believed, from analyzing this or other Federal decisions on the same point with a view to determining whether, in each case, the local law was applied, or the untrammeled views of the Federal Court were given place instead.

§ 29. The unfitness of the rule of local law.

Despite the impressive weight of authority in favor of a slavish adherence to "local law" in all points concerning the rights of creditors as against an un-

[19] *In re Marine, etc., Co., supra.*

See also *In re Southern Textile Co.* (174 Fed. 523), decided by the same court. In the recent case of *Ludvigh* v. *Am. Woolen Co.* 176 Fed. 145, Am. B. R. 314, on the other hand, Judge HOUGH mentions but few local decisions throughout his discussion of this subject.

[20] 91 U. S. 716.

[21] See preface to first edition.

recorded or illegal agreement of security, one cannot help regretting that the view of Shiras, J., in an early case[22] was not given more consideration than it apparently received. The learned judge there advanced the idea that while transactions in fraud of existing creditors should be governed by local law, those in fraud of subsequent creditors are solvable only on the principles of estoppel in applying which the Federal Courts should have a free hand. The Statute of Fraudulent Conveyances is part of the organic law of every state and the Federal Courts run little risk of capital error in following the State decisions in the given case. But the rights of subsequent creditors, as is shown in the text, depend on no statute, State or Federal, but on a doctrine which is peculiarly of equity, for whose administration the Federal Courts, by reason of their procedure and traditions are peculiarly fitted. Why this domain should not have been included in that territory of "general jurisprudence" or commercial law[23] in which the Federal Courts have declared themselves free from local rules,[24] is to be regretted. Indeed the fidelity of the Federal Courts to "local law," even in ideal cases, does not always stand the test.[25] Indeed, the Circuit Courts of later years have come around to the view of Shiras, J., in the respect at least that the doctrine of equitable lien and its enforcement lie outside the rules of local law.[26] The

[22] *Lyon* v. *Council Bluffs Savings Bank,* 29 Fed. 566.

[23] *Swift* v. *Tyson,* 16 Pet. 1.

[24] *Lake Shore Ry. Co.* v. *Prentice,* 147 U. S. 101, 13 Sup. Ct. Rep. 261.

[25] See the dissenting opinion of Holmes, J., in *Kuhn* v. *Fairmont Coal Co.,* 215 U. S. 349, 30 Sup. Ct. Rep. 140.

[26] *Hanson* v. *Blake,* 155 Fed. 342, 19 Am. B. R. 235; *In re Loveland,* 155 Fed. 838, 19 Am. B. R. 18.

rule of equitable estoppel is so bound up with the idea of equitable lien, in many cases, that the same freedom from local restraint should be allowed the Federal Courts. But that is a matter for the future, perhaps, to determine.

§ 30. **The practical result.**

The American law of reputed ownership, then, should be dealt with as unaided at any time by any National statute, and must be derived from giving equal effect, as far as possible, to the various decisions of the National and State courts.

CHAPTER IV.

REPUTED OWNERSHIP IN AMERICA — THE ABSENCE OF STATE LEGISLATION.

§ 31. No Reputed Ownership Statute in the State laws.

As we have seen, the four successive National Bankrupt Acts contained nothing similar to the Reputed Ownership Statute of England. Nor in any of the bankruptcy systems provided by the laws of the various States during the successive interregna afforded by the failure of Congress to enact a new National bankrupt statute in the place of the one just repealed, do we find anything of the sort.

§ 32. The State registration laws.

We do find, however, as a marked feature of American legislation, statutes enacted at an early date in all the States, respecting the registration of real estate transfers and the filing, in public office, of conditional bills of sale and chattel mortgages, where not accompanied by change in the possession of the bargained goods. And as we have seen, the present National Bankrupt Act confers upon the trustee all rights with which, by the law of the State of the property's location, creditors are vested through the failure of the grantee, vendee, or mortgagee to comply with the statutes relating to public notice of transfer.

§ 33. Their restricted sphere.

But these various State registration laws do not occupy the sphere of the English Statute of Reputed Ownership. In the first place, the laws for the regis-

tration of land titles confer no rights upon creditors in the event of the grantees' failure to comply with their terms; the only beneficiaries of such statutes are innocent purchasers of the property.[1] There is more diversity in the various State laws regulating the filing of chattel mortgages and contracts of conditional sale. In New York, for instance, an unfiled chattel mortgage, unaccompanied by change of possession of the goods, is void as against both the creditors of the mortgagor and innocent purchasers[2] whereas an unfiled conditional sale contract, in the like case, is void only as against innocent purchasers.[3] In some other States the same results follow equally, in favor of creditors, in the cases both of chattel mortgages and conditional sales, where the instrument expressing the agreement has not been filed, and possession of the property has not been given to the mortgagee or vendee.[4]

[1] The New York statute, Laws of 1896, ch. 542, § 241, is a fair sample of all the State statutes in this respect. A full discussion of it will be found in *In re Hunt,* 139 Fed. 283; 9 Am. B. R. 251.

[2] N. Y. Lien Law (Laws of 1909, ch. 38, § 230).

[3] N. Y. Personal Property Law (Laws 1909, ch. 38, § 62); *Supply Co.* v. *Schirmer,* 136 N. Y. 305; *Greaves Elevator Co.* v. *Callamon,* 111 App. Div. 301, 42 N. Y. Supp. 930.

[4] *Conditional Sales.*— In many states conditional sales are valid without record. In other states, record is required. Where no record is required, debtors frequently perpetrate gross frauds by obtaining false credit on the faith of absolute ownership of the goods sold under conditional sales. From an economic point of view conditional sales serve a most useful purpose in enabling worthy persons with small credit to buy expensive machinery and develop numerous small industries. There ought in the near future to be framed a uniform law governing conditional sales.

Chattel Mortgages.— There is a great diversity in the law of the various states upon the subject of chattel mortgages. In the near future a uniform law upon this subject should be framed.

(From Report of Committee on Commercial Law, American Bar Association Reports, 1909, Vol. 34, p. 1100.)

§ 34. The result.

It would serve no useful purpose to further notice these State laws. The provisions for the registration of land transfers, for instance, have no direct application to the question of reputed ownership, and their application to this subject is of but an accidental nature in particular cases. It need only here be observed that while the custom of registering land transfers, indeed, will often operate to prevent the presumption of ownership in one in whom the record title does not lie,[5] yet, on the other hand, it suggests in many cases, a mode of affording a presumptive ownership by the simple expedient of withholding the latest deed from record.[6]

§ 35. Conditional sale contracts and chattel mortgages.

So, too, with the State laws respecting unfiled conditional sale contracts and chattel mortgages. The rule which was expressed by a common law writer in *Twyne's case*,[7] enacted in the Statutes of Fraudulent Conveyances and of Reputed Ownership, and applied by the English chancellors in the strength of their own jurisdiction, was simply that the possession of property was a powerful lever for the wronging of creditors, unless it was in the party to whom, if the transaction had been honestly projected, it would have belonged. These State laws which we have mentioned doubtless found origin in the same idea. But their range is narrower even than that of the Statute

[5] *Sexton* v. *Wheaton*, 8 Wheat. 229, 251, 252.

[6] *Trenton Banking Co.* v. *Duncan*, 86 N. Y. 221; *Sloan* v. *Huntington*, 8 App. Div. 93; *City Bank* v. *Hamilton*, 34 N. J. Eq. 159; *Water's Appeal*, 35 Pa. St. 523; *Pierce* v. *Homer*, 142 Ind. 626.

[7] 3 Co. Rep. 80b.

of Reputed Ownership. They fail to comprehend any transactions, however, of frequent occurrence, where fraudulent ostentation of ownership is afforded, saving only in cases of chattel mortgages, and, in some States also, of conditional sales as well.

§ 36. The probable reason.

As we have seen,[8] the Reputed Ownership clause as originally enacted in the Statute of James, and successively re-enacted in the various English Bankrupt Statutes of a later day, received an interpretation by the common law courts which rendered it harsh, inequitable, and, to a decided extent, intolerable. This fact, as we believe, accounts for the omission of Parliament to include a similar clause in the winding up provisions of the Companies Acts. Perhaps some of the dissatisfaction existing in England with the Statute which had been enacted in the early days, accounts for the nonappearance of this act in any of our State compilations.

§ 37. The estoppel principle the only substitute.

However that may be, it is certain that in several of the States the early English common law decisions under the Reputed Ownership Act have been mistaken for declarations of the common law itself. Consequently, in certain States, notably Illinois and Pennsylvania,[9] a conditional sale is void as against the creditors of the vendee as matter of law.[10] As

[8] Ch. II.

[9] See *In re Rinker,* 174 Fed. 490, 23 Am. B. R. 62, and cases there cited.

[10] In Pennsylvania only against attaching creditors. *Post* v. *Berwin Coal Co.,* 176 Pa. St. 297; *Davis* v. *Crompton,* 158 Fed. 735, 20 Am. B. R. 53.

Mr. Justice Bradley has pointed out,[11] the doctrine thus enunciated arose from a misunderstanding of the Statute of James, and, in fact, was not even in accord with the later decisions under that statute.

> "This presumption of property in a bankrupt, arising from his possession and reputed ownership," said the learned Judge, "became so deeply imbedded in the English law that in process of time many persons in the profession, not adverting to its origin in the statute of bankruptcy, were led to regard it as a doctrine of the common law."[12]

[11] *Harkness* v. *Russell,* 118 U. S. 663, 7 Sup. Ct. Rep. 51.
[12] *Harkness* v. *Russell, supra.*

CHAPTER V.

THE ESTOPPEL PRINCIPLE AS A SUBSTITUTE FOR THE STATUTE.

§ 38. Estoppel the thesis of the English statute.

Though none of our States has, nor has Congress, ever enacted a statute similar to the Reputed Ownership clause of the English Bankrupt Acts, yet the remedy which that statute in crude terms attempted to confer may be found in the equity conception of estoppel. To use the language of Mr. Justice Bradley, the principle of this statute is just, and "wherever the case occurs equity will favor the application of the principle."[1] Equity is adequate to give relief out of its own strength, just as would have been demonstrated in England in all such cases had legislation not anticipated the growth of the Court of Chancery.

The principle governing such cases requires but to be stated to commend itself to any chancery judge, "that possession with reputed ownership renders property liable for the debts of the possessor to those who have given him credit on the faith of it."[2] As the New York Court of Appeals has said,[3] there is no reason why the same principle which would shield a purchaser of property from one with the ostensible ownership thereof "should not protect creditors who have given credit on the faith of the apparent ownership of property in the possession of a debtor against a secret unrecorded conveyance fraudulently con-

[1] *Frelinghuysen* v. *Nugent*, 36 Fed. 229, 237.

[2] Bradley, J., in *Frelinghuysen* v. *Nugent*, 36 Fed. 229, 237.

[3] *Trenton Banking Co.* v. *Duncan*, 86 N. Y. 221.

cealed by the debtor." In the case of a purchaser of property, the possession of which was held under such circumstances, the doctrine of estoppel, as an English judge has said, always "gets rid of the difficulty."[4] The same rule of estoppel furnishes the solvent for cases of reputed ownership where creditors' rights are involved.

§ 39. Legislation not necessary.

In one leading instance, where an insolvent's creditors asserted a case of ostensible ownership, Mr. Justice Strong in holding against them on the facts took occasion to say:

> "If it be said that the failure to put it on record enabled the debtor to maintain a credit, which he ought not to have enjoyed, the answer is that the Bankrupt Act was not intended to prevent false credits. Its purpose is ratable distribution."[5]

It is quite true, as we have seen, that none of our Bankrupt Acts have contained a provision similar to the Reputed Ownership clause of the English Bankrupt Statutes, which was intended to prevent false credits. But we need no bankrupt act for that purpose. The courts of equity are sufficient in this respect.

§ 40. The English chancery's interpretation of the statute.

As we have seen, the common-law courts of England placed upon the statute a construction which was

[4] *Weiner* v. *Gill* (1906), 2 K. B. 574.
[5] *Sawyer* v. *Turpin*, 91 U. S. 114.

inconsistent with justice. But prior to their manipulation of the ideas which the statute attempted to express, the chancery judges of England and Ireland, by several illuminating decisions which deserve more appreciation than the common-law courts afterward accredited them, had extracted from the statute the true principle of estoppel. Lord Fitzgerald in *Colonial Bank* v. *Whinney*,[6] erroneously says that this statute "does not appear to have been put into actual operation for a long period after its enactment. It had almost become obsolete, and was first really expounded by Lord Hardwicke more than a century afterward." In point of fact, the statute was first construed by the High Court of Chancery many years before Lord Hardwicke took his seat upon the woolsack.

§ 41. **Copeman v. Gallant.**

The first case found under this statute is *Copeman* v. *Gallant*.[7] This was before Lord Cowper, L. C., in 1716. It appeared that A. made a general assignment for the payment of his debts, but the assignee later became a bankrupt. Counsel for the assignee, in resisting the claim of the trustee in bankruptcy (as we shall, for convenience, style him) argued that the statute was intended only to prevent a fraud in the bankrupt, because continuance of possession is strong presumptive evidence of the fraud. He also argued that the preamble of the statute, which referred to bankrupts conveying their goods, restrained the succeeding general words to cases where the bankrupt had made a sale to another and yet had not delivered possession, as distinct from the reverse case where

[6] 11 A. C., at p. 412.

[7] 2 Eq. Ca. Ab. 113, pl. 2; 1 P. Wms. 314.

somebody else had put the bankrupt in possession of goods, retaining some ownership therein. The Lord Chancellor refused to allow the opinion that the preamble should restrain the operation of the enacting clause, but held the case not to be within the statute, because the assignment "was with an honest intent."

§ 42. The right result reached.

Lord Cowper's idea that the preamble of the statute was not a factor in its interpretation was later criticised.[8] But the correct result was reached in the case. In another place will be mentioned the numerous decisions in both the common law and equity courts, whose effect was to remove from the ban of the statute the many familiar cases of every-day occurrence, where apparent ownership was denied its statutory consequences because of the honesty of the transactions of which it was an incident.

§ 43. Other early chancery cases.

Although in *Hungerford* v. *Earle*[9] the court doubted its jurisdiction to aid creditors against a conveyance prescribed by the Statute of Fraudulent Conveyances, yet by the time Lord Kenyon became Master of the Rolls the power of equity to deal with such cases had become settled.[10] In *Hungerford* v. *Earle*, however, the court *obiter* says that "a deed, not at first fraudulent, may afterward become so by being concealed or not pursued, by which means creditors are drawn in to lend their money." This is a precise statement of the applicable doctrine of estoppel.

[8] Parker, C. B., and Lord Hardwicke, *Ryall* v. *Rowles*, 1 Ves. Sr. 348, at 365 and 371.

[9] 2 Vern. 261.

[10] *Hobbs* v. *Hull*, 1 Cox C. C. 446.

§ 44. **The decision of Lord Hardwicke.**

Lord Hardwicke was the first to give a really authoritative exposition of the Statute of Reputed Ownership. When that law first came before his attention, he summoned the principal law judges to assist him in its construction, because, he said, of "the want of a number of authorities as to the construction of this Act of Parliament, though made so long ago."[11] The case in which he sat was *Ryall* v. *Rowles*.[12]

§ 45. **Ryall v. Rowles — The question.**

There the pretended ownership was of choses in action, among other things. If the Statute of James did not apply, then as it was argued, the real owner was entitled to his goods despite the creditors of the pretended owner.

§ 46. **The decision.**

Lord Hardwicke agreed that the statute did not apply. Such being his position, and the common-law judges, whom he summoned for their opinions, being clear that the case was not within the Statute of Elizabeth, the value of the equity system was put to the test. It could not be denied that the title to the property was not in the pretended owner. There was only one way in which the difficulty could be avoided, and the equity of the case vindicated, and that was by means of the doctrine of estoppel.

[11] "The eleventh section does not appear to have been put into actual operation for a long period after its enactment. It had almost become obsolete, and was first really expounded by Lord Hardwicke more than a century afterward." Lord Fitzgerald in *Colonial Bank* v. *Whinney*, 11 A. C., at p. 412.

[12] 1 Ves. Sr. 348.

The reasoning of Lord Hardwicke in *Ryall* v. *Rowles*[13] is not so clearly reported in Vesey as might be desired.[14] But it at least would seem clear that he applied the doctrine of equitable estoppel. He states that "the general view and intent of the provision, now under consideration, was to prevent traders from gaining a delusive credit by a false appearance of substance to mislead those who would deal with them." His opinion is that "as to the choses in action comprised in these securities, where it is admitted none could pass (but) in equity, equity ought to follow the law in this case, if in any. Where property is established by Act of Parliament, equity follows it in like manner where established by common law."

The practical view of the Lord Chancellor is again emphasized by his remark during the argument of counsel:

> "It is said this will prevent an assignment of stock in trade; but an absolute assignment of all stock in trade would hardly be good in cases of bankruptcy, even laying it out of this act; it was so said by the Master of the Rolls in *Small* v. *Oudley;*[15] it being only ideal and carrying a badge of fraud."[16]

[13] 1 Ves. Sr. 348.

[14] "That great Chancellor who did so much in the illustration of equitable principles was not happy in the reporters who have transmitted to us his judicial decisions." Lord Fitzgerald in *Hardy* v. *Fothergill,* L. R. 13 A. C., at p. 364.

[15] 2 P. Wms. 427; 2 Eq. Cas. Ab. 122, pl. 2.

[16] Here is the germ of the idea which later found voice in the Sales in Bulk Acts of our larger States. "*Bulk Sales.*— There has been much complaint as to the fraudulent sale of goods in bulk. Acts to reach this evil have been passed in the thirty-five (35) states of California, Colorado, Connecticut, Delaware, District of

§ 47. Ryall v. Rowles — Its doctrine.

The statute, as expounded by Lord Hardwicke, therefore, expresses the principle of estoppel. As Lord Blackburn, over a century later, comments, the law "never was so unjust as to take his (the true owner's) property, unless it was left by him in such circumstances that credit might have been obtained upon it."[17]

§ 48. Joy v. Campbell.

Similar views were later advanced on the same act, as enacted for Ireland, by Lord Redesdale, whose judgment, in *Joy* v. *Campbell*[18] has been characterized as "the best exposition of the law."[19] The effect of this statute, observes Lord Redesdale, is not a forfeiture of the property. "The object of the act," he continues, "was to prevent deceit by a trader from the visible possession of property to which he was not entitled."[20] It is not enough that credit be given on the property; there must be more

Columbia, Florida, Georgia, Idaho, Illinois, Indiana, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Montana, Nebraska, Nevada, New Jersey, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Tennessee, Utah, Vermont, Virginia, Washington and Wisconsin. These acts were declared unconstitutional in Illinois, Indiana, New York, Ohio and Utah. New York, Utah and Ohio have re-enacted similar acts with the unconstitutional provisions omitted. It is possible that in the future a Uniform Bulk Sales Act will be framed so that it might become uniform throughout the United States." (From Report of Committee on Commercial Law, American Bar Association Reports, 1909, vol. 34, pp. 1099, 1100).

[17] *Colonial Bank* v. *Whinney*, 11 A. C. 426, 436.

[18] 1 Sch. & Lef. 328.

[19] Parke, B., in *Whitfield* v. *Brand*, 16 M. & W., at p. 282.

[20] *Joy* v. *Campbell*, 1 Sch. & Lef. 328, 336.

than that to make it inequitable. It was the "unconscientious" permission to the bankrupt, given by the true owner, at which the statute aimed.

§ 49. Other decisions.

The result reached in *Ryall* v. *Rowles* was followed in later cases.[21]

It does not, however, contain the only expression of Lord Hardwicke's views on this subject. In *Taylor* v. *Jones*[22] the Lord Chancellor held that a settlement of stock made by a husband in trust for the benefit of himself for his life, then for the life of his wife, and afterward for the benefit of their children, was void as against the husband's subsequent creditors, because it appeared on the facts that the husband continued in possession of the property after the execution of the deed. One reason assigned was the probability "that the creditors, after the settlement, trusted Edward Jones, the debtor, upon the supposition that he was the owner of this stock, upon seeing him in possession." As the property here consisted of stock, which, being of the nature of a chose in action, was not within the Reputed Ownership Statute, it is of equal value with *Ryall* v. *Rowles*, as showing the bent of the chancery court toward the principle expressed by that statute.

§ 50. Troughton v. Gitley.

The case of *Troughton* v. *Gitley*,[23] though of no authority on the point ruled,[24] is of value here as

[21] *Ex parte Ruffin*, 6 Ves. Jr. 128; *Ex parte Williams*, 11 Ves. 7; *Jones* v. *Gibbons*, 9 Ves. 407.

[22] 2 Atk. 600.

[23] Amb. 630.

[24] *Ex parte Martin*, 15 Ves. 114, 116; *Ex parte Brown*, 4 Bro. C. C. 211.

showing that the same thought also occurred to Lord Camden, that the principles of equity could have effected the same result as the Statute of James. In holding that, on the second bankruptcy of an undischarged bankrupt, whose creditors under the first commission had permitted him to start business with the assets subject to their claims, the second set of creditors were to be preferred, the Lord Chancellor said:

> "This is a declaration to all mankind that he had sufficient capacity. It falls within the principle that if a man having a lien stands by and lets another make a new security, he shall be postponed."

Whether his view of the policy of the Bankruptcy Statutes, which moved Lord Loughborough[25] to overrule *Troughton* v. *Gitley,* was right, is immaterial. The value of Lord Camden's decision to us lies in its recognition of a principle which, had it become commonly known at an earlier date, would probably have obviated the adoption of the Statute of James.

§ 51. The result of these decisions.

Thus, at the opening of the nineteenth century, it had been manifested that the processes of equity were adequate to give relief in cases not strictly covered by the Statute of Fraudulent Conveyances, nor yet the Statute of Reputed Ownership. Whether or not Lord Mansfield was right when he declared[26] that the Statute of Fraudulent Conveyances was merely an expression of certain inherent doctrines of the com-

[25] *Ex parte Brown,* 4 Bro. C. C. 211.
[26] *Cadogan* v. *Kennett,* 2 Cowp. 432.

mon law, it does seem true that the Statute of Reputed Ownership is the expression of the estoppel principle of equity.

§ 52. **The adequacy of the estoppel idea.**

One point, in closing, may be of interest. As we have seen, the Statute of Reputed Ownership could not, by its terms, apply to the case of an assignment of choses in action, yet, in such a case, which was cognizable only in equity the chancery court followed the spirit of the statute, because it expressed a natural principle of justice. So it was with fraudulent transfers of choses in action. In like manner, the Court of Chancery, from an early date, followed the spirit of the Statute of Fraudulent Conveyances, and held void assignments of choses in action, although that statute was deficient in this respect, like the later Statute of James.[27] Hence, even though neither of these statutes should enter a country adopting the English jurisprudence as it stood at the close of the eighteenth century, yet the same results would be attained, on any such new soil, through the operation of the estoppel principle of equity, of which the instances cited have only afforded a glimpse.

[27] See *Hall* v. *Alabama Terminal Co.*, 143 Ala. 464, 2 L. R. A. N. S. 130, for a full discussion of this point.

CHAPTER VI.

GOOD FAITH THE TEST OF THE TRANSACTION.

§ 53. The statement, and reliance thereon.

An estoppel is not created merely by the fact that the aggrieved party relied on a representation; it must appear that the party sought to be charged either made or was responsible for the representation, and had the intention that the plaintiff would believe it and act accordingly. In the case of reputed ownership, the representation to the creditor, of course, is that the insolvent owns the property. The creditor's reliance upon the representation results in his giving credit to the insolvent. This may be a fresh credit, or indifferently, it may be an extension of time under a matured obligation.[1]

> "We apprehend," says the Alabama court, "that a correct general statement of the doctrine invoked here would embrace every case where the party complaining has been drawn in to part with money or property or valuable rights, or to change to his detriment the legal effect of existing contracts, in consequence of the fictitious standing given to or allowed to be retained by the party with whom he deals, through and by misrepresentations, or, what is the same in legal contemplation, fraudulent concealments."[2]

§ 54. The nature of the representation.

This representation is afforded through the medium of the insolvent being in possession of the property and exercising over it such power of dispo-

[1] *Root* v. *Harl*, 62 Mich. 420; *Centr. Bank* v. *Van Doren*, 109 Mo. 40; *Lehman* v. *Van Winkle*, 92 Ala. 443.

[2] *Lehman* v. *Van Winkle*, 92 Ala. 443.

sition as commonly is exercised by one who is the owner of it. But to make an estoppel in such a case it must be shown that the true owner was responsible for the representation. Hence, it is not enough to show merely that the insolvent was in possession of the goods and apparently the owner. "That credit is given on the property," says Lord Redesdale,[3] "is a circumstance that might belong to a variety of other cases not within the statute." Obviously it is not sufficient merely to show that the true owner gave his consent to such an arrangement. Had such a view of the Statute of James prevailed, even in the common-law courts, that enactment would very soon have been wiped off the statute books, because it would have stifled the legitimate operations of merchants.

§ 55. The innocent representation — Such as a general assignment.

In the first case where the nature of the statute came before the chancery it was held that, where an assignee for the benefit of creditors becomes bankrupt, the property under his administration in his capacity of assignee is not available for his creditors.[4] Yet there the property was in possession of the assignee, to all outward appearances as its owner, for there was no statute requiring such deeds to be filed or recorded in public office. But the prevailing reason for a contrary determination, according to the court, was that the assignment was "with an honest intent."

§ 56. The innocent representation — Other cases.

Although the language of Lord Cowper in the case just cited, respecting the intent of the parties as being

[3] *Joy* v. *Campbell*, 1 Sch. & Lef. 328, 338.

[4] *Copeman* v. *Gallant*, 2 Eq. Ca. Ab. 113, pl. 2, 1 P. Wms. 314.

all sufficient, received the criticism of Parker, C. B., in *Ryall* v. *Rowles*[5] yet the result reached by the Lord Chancellor commends itself to every consideration of justice. And even before the court, in *Ryall* v. *Rowles*[6] gave the statute the construction which would render it both consonant with justice and the customs of trade[7] the common-law courts had taken the first steps toward removing from the ban of the statute like cases where, had the statute prevailed, not only would the principles of estoppel have been ignored, but the ordinary honest dealings of mankind would have been greatly affected. Although these decisions, to use Lord Hardwicke's words,[8] proceeded contrary to the plain language of the statute, yet their justice cannot be gainsaid. Thus in *Mace* v. *Cadell*[9] it was held that goods in a factor's hands do not fall within this description. So where there had been an equitable mortgage of lands by the deposit of title deeds, it was held, though with regret, by Kenyon, M. R., that the case was not within the statute.[10]

§ 57. Illustration of the distinction.

Two cases illustrate the distinction presently to be stated. In *Edwards* v. *Harben*[11] there is a notable *dictum* by Buller, J., that a conditional sale transaction was within the statute, if the vendee was let into possession of the bargained property. But in *Martin-*

[5] 1 Ves. Sr. 348.

[6] *Supra.*

[7] See the judgment of Mellish, L. J., in *Ex parte Watkins,* L. R. 8 Ch. App. C. 520, 533.

[8] *Ex parte Dumas,* 2 Ves. Sr. 582, 585.

[9] 1 Cowp. 233.

[10] *Edge* v. *Worthington,* 1 Cox Ch. C. 211.

[11] 2 T. R. 587.

dale v. *Booth*[12] this was overruled, and it was held that, if such possession had been made one of the terms of the original contract, no case of ostensible ownership was presented.

Other cases and instances might be cited, out of the old reports, but it is believed that those above mentioned serve to bring out the distinction aimed at. This finds expression in the language of Lord Hardwicke[13] where, discussing the instance of goods in a factor's possession, which as we have seen are not available to his creditors under the statute, the Lord Chancellor adverts to the fact that in such cases the goods were not originally "put into the hands of the factor for a fraudulent purpose." Possession, in the view of Mr. Justice Burnet,[14] is not otherwise a badge of fraud, unless as calculated to deceive creditors." In *Joy* v. *Campbell*[15] Lord Redesdale makes the test whether the possession had "unconscientiously" been left with the insolvent.

§ 58. Good faith the test.

The test, then, is the good faith of the original transaction. The responsibility of the true owner for the representation afforded creditors by the possession of property, with the habiliments of ownership, by an insolvent, depends upon whether the nature of the original transaction was such that, in the minds of the parties at that time, the insolvent could, consistently with the transaction, have obtained credit on the faith of the ostensible ownership.

[12] 3 B. & Ad. 498.
[13] *Ex parte Dumas,* 2 Ves. Sr. 582.
[14] *Ryall* v. *Rowles,* 1 Ves. Sr. 348, 360.
[15] 1 Sch. & Lef. 328.

§ 59. The test discussed.

Doubtless this test does not make the true owner the insurer of the trader's good faith in his subsequent dealings with the public. But the law should not cast such a duty upon the true owner. It should hold him to what he could reasonably have foreseen, but not for the unforeseen wrongdoing of the trader. "The possibility of this being done cannot enter into consideration upon the question of reputed ownership," says Lord Selborne, L. C.[16] The true owner, according to Lord Blackburne, is not bound to assume, at the outset, that the trader is a "fraudulent liar;"[17] or the possibility of an intervening fraud or crime.[18] All the true owner should be held to are the natural and reasonable consequences of his own conduct, and not results that, for their consummation, must depend upon an unforeseen fraud on the part of the trader.

This test, it is believed, will conform to the various lines of cases decided upon this branch of the law of equitable estoppel. The purpose of a factor, a trustee, or an assignee for creditors, to obtain credit on the faith of the property held by him, if confessed before the commission were intrusted to him, would, in all human calculation, result in the trusts being reposed elsewhere. "The goods," says Lord Mansfield, "must be such as the party suffers the trader to sell as his own."[19] It is the true owner's state of mind at the time of the original transaction, resulting in the insolvent's gaining possession of the goods, that must be examined.

[16] *Ex parte Watkins,* L. R. 8 Ch. App. 520, 531.
[17] *Colonial Bank* v. *Whinney,* 11 A. C. 426, 438.
[18] Lord Ashbourne in case last cited.
[19] *Mace* v. *Cadell,* Cowp. 232, 3 P. Wms. 186.

§ 60. Illustration — Am. Sugar Ref. Co. v. Fancher.

Apt illustration is afforded as well by many modern cases. An extreme case in the one direction is afforded by *American Sugar Ref. Co.* v. *Fancher.*[20] There the well-settled rule which allows an unpaid vendor to rescind a sale contract upon discovery of the insolvency of the vendee and to retake the goods delivered thereunder was enforced as against a general assignee for the benefit of creditors, into whose hands had come the proceeds of sales of the property made by the vendee. Speaking of the rights of the creditors of the vendee to this money, the court said:

> "They, so far as it appears, advanced nothing and gave no credit on the faith of the firm's possession of the sugars, assuming that that element would have had any bearing on the case."

Of course in such a case the creditors of the vendee would have no equity superior to that of the rescinding vendor. It was not the latter's fault that the vendee's creditors were misled by his apparent ownership. The vendor had sold the goods in good faith, and his right of rescission was superior as a prior equity to whatever claim the vendee's creditors might otherwise have had on the grounds of estoppel. In that respect the case was like *Edge* v. *Worthington*[21] where an equitable mortgage of lands was held superior to the claims of creditors, although ostentation of ownership was fully afforded. The equity of the mortgagee was prior and was created in good faith, and, therefore, prevailed over the subsequent equity of the creditors.

[20] 145 N. Y. 552.
[21] 1 Cox C. C. 211.

§ 61. Illustration — Sawyer v. Turpin; Robinson v. Elliott.

In *Sawyer* v. *Turpin*[22] a chattel mortgage which was recorded just prior to the bankruptcy of the mortgagor was given in exchange for a previous unrecorded bill of sale of the same property, the mortgagor remaining in possession meanwhile. The Supreme Court held that the mortgagee's right was superior to that of the creditors of the mortgagor, because "the evidence does not justify the assertion that there was, in fact, an agreement that the bill of sale should not be recorded or that possession should not be taken under it." If, on the other hand, there had been an agreement to withhold the deed from record, then, as against creditors, who had given credit upon the faith of the possession of the property by the mortgagor, the mortgagee would have no rights. That was the decision in *Robinson* v. *Elliott*.[23]

§ 62. Porter Co. v. Boyd.

In *H. K. Porter Co.* v. *Boyd*,[24] on the contrary, the vendor had sold goods, no fraud having been practiced upon him by the vendee, and afterward endeavored to create a vendor's lien upon them by a subsequent agreement between himself and the vendee. With his eyes wide open he had permitted a situation of ostensible ownership, and, therefore, had to take the consequences.

The idea of good faith runs through all the cases on this subject, and further elaboration of instances at this point would be to anticipate the succeeding chapters of this work.

[22] 91 U. S. 114.

[23] *Robinson* v. *Elliott*, 22 Wall. 513.

[24] 171 Fed. 305.

§ 63. Actual intent not necessary.

True, in this as in other cases of estoppel,[25] no actual fraudulent intent need be imputed or proven against the true owner of the property. It is enough if the representation is allowed by him in contemplation of the probable result that creditors of the insolvent will rely thereon to their detriment. A specific intent to deceive one or more, or even a class of creditors, need not be shown. It is enough if the bad faith of the transaction appears in that the facts would warrant the belief that the true owner contemplated the natural result of the transaction. This idea is well expressed by Hough, J., in *Ludvigh* v. *Am. Woolen Co.*[26] There a so-called consignment agreement was held, as against the creditors of the consignee, the latter becoming insolvent, to be as though it were a contract of sale, inasmuch as it allowed the consignee the outward rights of an owner of the bailed goods. The learned judge expressly exonerated the defendant from any fraudulent intent in fact, but held it to the natural consequences of the transaction, however innocent might have been the motive of its inception.

§ 64. Unsound criticism of Hilliard v. Cagle.

In an early decision the Supreme Court of Alabama criticized *Hilliard* v. *Cagle*,[27] hereafter discussed, because that case "seems to go to the extent of creating an estoppel in favor of creditors generally, without any actual fraud being imputed to the mortgagee in

[25] *In re American Knit Goods Co.*, 173 Fed. 480; *Carr* v. *National Bank*, 167 N. Y. 375; *Smith* v. *Richards*, 13 Pet. 26; *Vail* v. *Reynolds*, 118 N. Y. 297.

[26] 176 Fed. 145, 23 Am. B. R. 314.

[27] 46 Miss. 309.

withholding his mortgage from registration."[28] This criticism does not seem well founded. The Mississippi court, like the other courts in cases of this kind, considered the circumstances surrounding the original transaction as being of a nature which, in the true owner's mind at the time of the transaction, reasonably could lead to the result of misleading the creditors of the insolvent. It is difficult, indeed, to support the reasoning of the Alabama court. The mortgage there was given to a bank, with an express agreement to withhold it from the record upon which, naturally, it should have been placed. The decision is of doubtful validity even in Alabama.[29]

§ 65. The ultimate question.

Whether the secrecy of the transaction results from the central idea of keeping up a going trader with a supply of goods, so that, on the faith of it, he may keep his other lines of custom open, an instance of which is *Ludvigh* v. *American Woolen Co.*,[30] or merely the retention of strings upon the property for general security, which is the strictest case that can be made out in the ordinary instance by attacking creditors, the result is the same. The question ultimately is, has the owner acquiesced in an arrangement which would be inconsistent with the debtor obtaining credit on the faith of the property thereby intrusted to him?

[28] *Mobile Bank* v. *McDonald*, 87 Ala. 736, 745.

[29] See *Lehman* v. *Van Winkle*, 92 Ala. 443, 450; *Clayton* v. *Exchange Bank*, 121 Fed. 630, 634, 10 Am. B. R. 173.

[30] 176 Fed. 145, 23 Am. B. R. 314.

CHAPTER VII.

THE PRESUMPTION OF RELIANCE.

§ 66. Reliance must appear.

To properly adjust the rights of creditors in a case of presumptive ownership requires, as we have seen, the inquiry for an estoppel. Hence there must always be present that necessary element of every estoppel, the reliance, by the injured party, on the representation complained of.

§ 67. Proof of reliance.

In many cases of presumptive ownership, we find the creditor of his own motion shouldering the burden of proving that his reliance upon the ostensible situation with respect to the title of the property led to his giving credit to the failing debtor. Such cases, though numerous in the books, need little comment here, because their respective determinations turned, of course, merely on the particular question of fact, did the creditor in fact rely, to his detriment, on the apparent situation which he alleged and has attempted to prove? Thus in *Trenton Banking Co* v. *Duncan*,[1] the plaintiff failed in the proof of this fact, which he voluntarily put forward as part of his *prima facie* case; and so, too, did the plaintiff in *Friedlander* v. *Johnson*.[2] And in the recent case of *In re Coffin*,[3] where a secret trust was enforced against the bankrupt's estate, the court, through Lacombe, J., said:

> "It appears from the referee's findings of fact that credit was not given or extended by any

[1] 86 N. Y. 221.
[2] 2 Woods, 675, 9 Fed. Cas. No. 5,117.
[3] 152 Fed. 381, 2 Am. B. R. 344.

creditors upon the strength of Coffin being the owner of the lands and property in question. This simplifies the situation, because under such circumstances the trustee in bankruptcy stands in no better position than that in which the bankrupt stood on the day the petition was filed."

On the other hand, we find the creditors successful in their proofs on such a head in several cases.[4]

§ 68. Presumptive reliance.

Of interest here, however, are those cases that raise the point of so-called presumptive fraud. The question presented by a review of such decisions concerns the nature and extent of the presumption in which a court will indulge while trying a case of this sort.[5]

§ 69. Creditors as a juristic entity.

One's creditors, at common law, never constitute a juristic person. But certain obvious points of convenience always present themselves to the courts in cases involving the administration of an insolvent's affairs, and have resulted in recognition of creditors as a juristic body in more than one way. Familiar examples of this appear in the practice governing the course of any decedent's or bankrupt's estate. The

[4] *In re Braselton,* 169 Fed. 960; *Clayton* v. *Exchange Bank,* 121 Fed. 630, 10 Am. B. R. 173; *Blennerhassett* v. *Sherman,* 105 U. S. 100.

[5] There are reported cases where actual false representations were proven to have been made to the complaining creditors. The prominence of these cases, like those cited in the text, requires their mention, but they are of no value to this discussion. *Wachusett Bank* v. *Swink Stove Works,* 63 Fed. 366; *Bank of U. S.* v. *Housman,* 6 Paige, 526.

constructive service of notices to creditors by mailing or publication is a good example; so, too, is the rule that a discharge in bankruptcy bars the claim of every creditor who had reason to know the pendency of the bankruptcy proceedings. The filing of the petition in bankruptcy, says the Supreme Court, "is a *caveat* to all the world, and in effect an attachment and an injunction."[6] Indeed all bankruptcy statutes, and numerous other laws relative to trade, adopted in the course of the centuries, of which but a late instance is the New York Sales in Bulk Act,[7] have their origin in this idea, slow of growth in the English law, and retarded by the peculiar agencies of progress afforded by our system of jurisprudence, that there is such a class of persons as creditors, which, for reasons more than of mere convenience, must, in many cases, be treated as a corporate body.[8]

§ 70. The rule of presumption.

Such a view, it is submitted, should be held by the courts in cases of presumptive ownership. And that

[6] *Mueller* v. *Nugent*, 184 U. S. 1, 24 Sup. Ct. Rep. 269.

[7] See *Wright* v. *Hart*, 182 N. Y. 330; *Sprintz* v. *Saxton*, 126 App. Div. 421.

[8] The New York Sales in Bulk Law as originally enacted was held unconstitutional by the Court of Appeals. *Wright* v. *Hart*, 182 N. Y. 330. "But the value of that case as an authority is impaired by a recent decision of the Supreme Court of the United States, which upheld a statute of another State similar in all respects to the one overthrown by us, except that some of its provisions were less stringent. *Lemieux* v. *Young*, 211 U. S. 489." Vann, J., in *People* v. *Luhrs*, 195 N. Y. 333. Meanwhile, an emasculated substitute for the original statute has been upheld. *Sprintz* v. *Saxton*, 126 App. Div. 421. The tenderness manifested by the court in *Wright* v. *Hart* regarding the commission of what has always been regarded as a gross fraud since *Small* v. *Oudley*, 2 P. Wms. 427; 2 Eq. Cas. Abr. 122, pl. 21, was indeed remarkable.

would result, it is believed, in this rule of evidence; that, where the circumstances disclose a transaction calculated to deceive creditors into believing that the insolvent owned certain property, the burden is on the real owner to show that the intended result was not attained as to the complaining creditors.

§ 71. Its basis.

The rationale of this rule is human experience. Presumptions of fact are based upon judicial observation, and the rule above stated expresses nothing but a presumption of fact, which, in each case, is rebuttable. Reduced to essentials, the doctrine of the courts, on this head, is merely that possession presumptively begets credit.

§ 72. Possession begets credit.

That was the leading resolve of *Twyne's Case*,[13] and, with but one recorded dissent[14] the idea there embodied has been voiced by all succeeding judges of the English-speaking world. "Men get credit for what they apparently own and possess," says our Supreme Court[15] through Mr. Justice Strong, and again, through the greater judge, Bradley, J., that court has declared it as the result of all observation that "if the debtor remains in possession, the law presumes that those who deal with him do so on the faith of his being the unqualified owner of the goods."[16]

[13] 3 Coke's Rep. 80b.

[14] Expressed by Parke, B., in *Whitfield* v. *Brand*, 16 M. & W. 325, 327.

[15] *Robinson* v. *Elliott*, 22 Wall. 513, 525.

[16] *Casey* v. *Cavoroc*, 96 U. S. 467.

§ 73. Any other rule would be impracticable.

To require proof by the complaining creditor in the first instance would be against all the practical standards of our procedure. "A rule of law so restricted" as has been said[17] " would be of very little value. It rarely occurs that a man can prove what it was that induced him to give credit." The rule above described, on the contrary, as the same authority says, " is a rule of general policy, which declares possession to be the evidence of property, and the presumption is that every man is trusted according to the property in his possession."

§ 74. The presumption is rebuttable.

Of course the defendant should be allowed to rebut this presumption. It is not fair that any creditor who knew the actual situation should be allowed to ignore it when it is to his interest so to do.

§ 75. Its application is practicable.

In *In re Hoffman,*[18] Referee Prentiss, whose decision was affirmed by Brown, J., thus rules:

> " It is claimed by the counsel for the bankrupt that as the creditor Boyle was no creditor at the time of the transfer, and has since, although suspecting the nature of the transaction, continued to deal with the bankrupt's successor in business, he is not in a position to set aside the transaction, but the question here is not what this creditor is in a position to do, but whether the facts are such

[17] Tilghman, C. J., in *Martin* v. *Mathiot,* 14 Serg. & R. (Pa.) 214, quoted in *H. K. Porter Co.* v. *Boyd,* 171 Fed. 305, 310.

[18] 102 Fed. 989, 4 Am. B. R. 331.

as to justify any action on the part of the trustee to recover these moneys for the creditors generally."

But it is submitted that this is incorrect. Under the authority of a later decision,[19] an easy method is provided for such cases. The Circuit Court of Appeals there misunderstood the New York law which it applied, as was later demonstrated.[20] But be that as it may, the court, believing that, under the local law, an unfiled chattel mortgage was void only as against creditors whose claims were reduced to judgment, directed that a decree in favor of the bankruptcy trustee for the mortgagor be reduced to such an amount as would satisfy the claims of those creditors only who lawfully could profit by the setting aside of the instrument. The same procedure should be followed in any case where the true owner shows that one or more creditors actually knew the situation before they extended credit to the insolvent. No recovery should be allowed for the benefit of any creditor as to whom such a finding is made. The rebuttal of the presumption, when successful, should have its proper consequences.

It is now in order to further inquire into the authorities in support of this presumption.

[19] *In re N. Y. Economical Co.*, 110 Fed. 514, 6 Am. B. R. 615.

[20] *Skilton* v. *Codington*, 185 N. Y. 80; *In re Gerstman*, 157 Fed. 549, 19 Am. B. R. 145.

CHAPTER VIII.

THE PRESUMPTION OF RELIANCE UNDER THE STATE COURT DECISIONS.

§ 76. The South Carolina cases.

Apparently, this presumption was early given shape in the South Carolina chancery.[1] "The question," says O'Neall, J.,[2] in an opinion that goes to the heart of the matter, "is not, was the gift good in the beginning; but between a volunteer and a creditor, which is to be preferred? And that question must be always answered by another, was credit given on the faith of the property?" And then, as the South Carolina courts determined, if the transaction was such that it might reasonably be supposed that credit was given "on the faith of the property," it is for the creators of such a situation to show that this, in fact, was not so. Creditors, asserts the same learned judge, in another case,[3] are "legally presumed to give credit on the faith of the property in their debtor's possession." This circumstance, says he, on yet another occasion,[4] is "in all events and in all cases * * * evidence of fraud until fully and clearly explained."

In each of the following cases the complaining creditors introduced no proof of actual reliance on the apparent ownership of the property; yet in each it was held that the transaction, on the case as it stood, was fraudulent.

[1] *Cordery* v. *Zealy,* 2 Bail. Eq. 205, 208; *Brock* v. *Bowman,* 1 Rich. Eq. Cas. 122; *Hudnal* v. *Wilder,* 4 McC. 306.

[2] *Farr* v. *Sims,* 1 Rich. Eq. Cas. 122.

[3] *Brock* v. *Bowman,* 1 Rich. Eq. Cas. 185, 190.

[4] *Cordery* v. *Zealy,* 2 Bail. Eq. 205, 208.

§ 77. **Mississippi — Hilliard v. Cagle.**[5]

"We are of opinion that the natural and logical effect of the agreement and assignment, and the conduct of the parties thereto, was to mislead and deceive the public," argues the court.

"And therefore," it concludes, "the whole scheme was fraudulent as to subsequent creditors, as much so as if it had been contrived with that motive and for that object."

That, of course, is true, as neither an evil nor a specific intent is a necessary element of an estoppel.[6]

§ 78. **Michigan — Root v. Harl.**[7]

The point, in the court's view, is whether the creditors have "done anything material which they may fairly be considered to have done on the basis of" the apparent ownership. An extension of credit, it is held, is within this category.

§ 79. **Missouri — Williams v. Kirk.**[8]

"It is true that there is no direct proof in this case that the creditor, when he dealt with the mortgagor, inquired for incumbrances on the property, or that he dealt with him on the faith of the property being unincumbered. But we must assume that in business affairs property is a basis of credit." The authorities cited for the presumption of reliance are *Hilliard* v. *Cagle* and *Root* v. *Harl.*[9]

[5] 46 Miss. 309, 345.
[6] See § 63, *supra.*
[7] 62 Mich. 420, 422.
[8] 68 Mo. App. 457, 462.
[9] *Supra.*

§ 80. **Pennsylvania — Water's Appeal.**[10]

"It is not an unreasonable presumption that the judgment creditors acted upon it. But for this, perchance, the credit had never been given." This case is of more value than its predecessor,[11] where, although the same result was reached, some reliance seems to have been placed on the fact that, originally, the transaction was framed with a view to defeating existing creditors as well.

Even more to the point is the language of Tilghman, C. J., in *Martin* v. *Mathiot*,[12] which has been cited already.[13]

§ 81. **Kentucky — Hildeburn v. Brown.**[14]

This case is of especial interest because of this excerpt from the opinion of the court: "Such contrivances or acts, though not designed to perpetuate an actual fraud upon other persons, have an inevitable tendency that way, and are obviously opposed to the general policy of the law regarding the public registration of all liens and incumbrances, upon property permitted to be retained and claimed by debtors." Here we see the same idea as animated Lord Hardwicke in the cases earlier discussed — the willingness of equity to conform itself to a statutory policy which, though deficient in scope, commends itself to the Chancellor's point of view. And so we find the court saying: "If not directly within that class of acts which the law denominates constructive fraud, it (*i. e.*,

[10] 35 Pa. St. 523.

[11] *Bunn, Raiguel & Co.* v. *Ahl*, 29 Pa. St. 387.

[12] 14 Serg. & R. 214.

[13] See § 73, *supra*.

[14] 17 B. Mon. 779.

apparent ownership of the nature under review) approximates so nearly to it that the party avowing himself a principal in such a transaction ought not to receive the countenance or aid of the Chancellor in enforcing any lien or claim growing out of it as against the third person."

§ 82. **Massachusetts — Macomber v. Parker.**[15]

"If the vendor or the pledgor should have the actual possession of the property after it were pledged or sold, it would only be *prima facie,* but not conclusive, evidence of fraud."

§ 83. **West Virginia — Speidel Grocery Co. v. Stark.**[16]

The assignment was a lease, and no statute required its recordation. "While ordinarily fraud must be proved, like any other fact, the law makes cases of this kind exceptional. It gives the creditor the benefit of a presumption, which the alleged purchaser must overthrow."

§ 84. **Georgia — Smith v. McDonald.**[17]

The defendant, logically construing the Statute of Fraudulent Conveyances, argued that a subsequent creditor had no right to complain of a certain "badge of fraud," for the very reason that it existed before his indebtedness arose, and the statute was intended to protect only existing creditors. The court, in denying that a subsequent creditor was entitled to nothing from the courts, said: "Indeed, the presumption is stronger in favor of the new debts than the old, for

[15] 14 Pick. 497.
[16] 62 W. Va. 512.
[17] 25 Ga. 379.

they may be supposed to have been contracted upon the credit given to the defendant on account of his possession and apparent ownership of the property."

§ 85. The converse proposition.

Support is afforded the doctrine of these cases by those enforcing the converse proposition, that there may well be constructive notice to creditors, which would deprive them of the benefit of this presumption. The cases on this line lay hold of the recording acts of the different States relating to the conveyancing of real estate, despite the fact that these acts as we have seen afford on their face no help to creditors. In the pioneer case, *Sexton* v. *Wheaton*,[18] it was held that the recording of the deed was ample to rebut the creditors' claims of reliance. This case represents the law.[19] The same idea was once expressed by Chancellor Walworth.[20] It would seem that the very use of this idea of constructive notice predicates a presumption for whose removal the doctrine of constructive notice is necessary. If, in such a case, there is no presumption that the creditors relied upon the apparent ownership, there would be no need for the court to look to whether constructive notice was afforded by the recording of the deed of transfer, in advance of the proofs, which the creditor otherwise would have to furnish, of the actual fact of his reliance.

[18] 8 Wheat. 229.

[19] *Schreyer* v. *Scott*, 134 U. S. 405, 10 Sup. Ct. Rep. 579; *Wallace* v. *Penfield*, 106 U. S. 260, 1 Sup. Ct. Rep. 216; *Phettiplace* v. *Sayles*, 4 Mason, 312, Fed. Cas. No. 11,083.

[20] *Bank of U. S.* v. *Housman*, 6 Paige, 526.

§ 86. **Cases to the contrary.**

In passing, it may be noted that two cases, *Breeze* v. *Brooks*,[21] and *Mobile Bank* v. *McDonald*,[22] appear to be against all this weight of authority. In both of these cases the view is that no situation, such as this book deals with, makes out a case for complaining creditors. In the California case, the majority of the court consider that the true owner "did no act to induce creditors to believe that the land was John's, save that he allowed the title to the record to stand in John's name, which title these creditors never examined." Outside of California, the dissenting opinion is to be preferred. In *Mobile Bank* v. *McDonald*,[23] practically the same view is taken; but this case has been not only judicially criticised[24] but practically overruled.[25]

[21] 71 Cal. 169.
[22] 87 Ala. 736.
[23] *Supra.*
[24] *Clayton* v. *Exchange Bank*, 121 Fed. 630.
[25] *Lehman* v. *Van Winkle*, 92 Ala. 443.

CHAPTER IX.

THE PRESUMPTION OF RELIANCE UNDER THE FEDERAL DECISIONS.

§ 87. Casey v. Cavaroc.

The oft-cited case of *Casey* v. *Cavaroc*,[1] on its actual facts, may be limited to the law of pledge. It was there held that a pledge is void as against the pledgors' creditors, if the pledgor has possession of the property.

The importance of this case, as affecting, in the Federal courts, the rules of estoppel applicable to cases of apparent ownership, is also large. The basis of the court's decision, as expressed by Mr. Justice Bradley, was that "if the debtor remains in possession, the law presumes that those who deal with him do so on the faith of his being the unqualified owner of the goods."

§ 88. Frelinghuysen v. Nugent.

With this in view, we can place a later circuit decision of Mr. Justice Bradley within that class of cases in which the creditors' reliance is presumed. In *Frelinghuysen* v. *Nugent*,[2] where the doctrine of ostensible ownership was applied, we find him saying that "the case made by the bill, then, stands upon the testimony of these two men," viz.: the cashier of the bankrupt company, and the defendant. No creditor testified as to his reliance on the apparent situation. Nor, apparently, did the judge deem it necessary, for he emphatically states that the just prin-

[1] 96 U. S. 467, Fed Cas. No. 2,496.
[2] 36 Fed. 229, 237, 238.

ciple of the English Statute of Reputed Ownership, whose application equity will favor, though we have no such statute, " should at least be so far regarded in a case like the present as to require the party claiming the benefit of the trust to make very clear and satisfactory proof of his right to make such claim."

In other words, the court in such a case presumes that the creditors were hurt, as would be the natural effect of the transaction, and it is for the parties who created the situation to show that, as it eventuated, the creditors did not become such by reason of it.

§ 89. The rule of In re Garcewich.

The Federal courts of the Second Circuit have furnished several valuable decisions in cases arising under the present Bankrupt Act. A decision of the Court of Appeals of that circuit has great value, *In re Garcewich.*[3] There was no proof in that case that any creditor was deceived, and both the referee and the district judge decided in favor of the transaction as against the creditors. The Court of Appeals reversed the order.

The opinion of the court, as expressed by Wallace, J., is that the transaction was " presumptively fraudulent." Criticism might, however, be made of that part of the opinion which states that such a transaction " will be deemed merely colorable, and the title to have been vested absolutely in the buyer." That is not an accurate statement of the case. As the transaction is not affected by the Statute of Fraudulent Conveyances, it is neither void nor colorable. The transactions of the parties are actual facts. A

[3] 115 Fed. 87, 8 Am. B. R. 149.

court of equity itself cannot ignore those facts; it can only compel parties to ignore them. The only case where the phraseology "sham," "colorable," and the like, can fitly apply, is where the conveyance falls within the Statute of Fraudulent Conveyances. *There* it is sham, and deserving of the other epithets, usual in these cases, as well. But a transaction attacked as a case of reputed ownership is valid in law; and, with us, no statute nullifies it. Relief is available only in equity, and there only through the power of that tribunal to compel parties to act despite their previous arrangements.

§ 90. Ryttenberg v. Schefer.

The later case of *Ryttenberg* v. *Schefer*,[4] contains a clear statement of the idea above sought to be expressed. After describing the case revealed by the evidence before him as "one of the numerous attempts to give a lien by owners of property while retaining the apparent ownership of it," Holt, J., applies the principle, stated in *Casey* v. *Cavaroc*,[5] that, "if the debtor remains in possession, the law presumes that those who deal with him do so on the faith of his being the unqualified owner of the goods."

§ 91. The Liberty Silk Co. case.

The same court, Hough, J., sitting, afterward added to the learning on this head. In *In re Liberty Silk Company*,[6] the same idea is expressed, that an ostentation of ownership is presumptively fraudulent, because "secret liens are to be discouraged." And

[4] 131 Fed. 313, 322.
[5] *Supra.*
[6] 152 Fed. 844, 18 Am. B. R. 582.

Ludvigh v. *American Woolen Co.*,[7] contains in the brief opinion which the same judge rendered in overruling a demurrer to a trustee's bill, as well as in his more elaborate judgment on final hearing,[8] statements leaning toward the same view.

§ 92. Other cases in the Second Circuit.

The recent case of *In re Southern Textile Co.*,[9] though turning entirely on local law, contains this commendation by Lacombe, J.: "We * * * must hold it to be a chattel mortgage, which under the statute of North Carolina would be valid against creditors only if recorded. Such a result is wholesome. The fewer secret trusts or liens there are the better. It may fairly be presumed that, if they had been notified by the record of this document that the bankrupt had practically transferred everything to Blythe & Corr, the present creditors of the textile company would not have extended credit to it." With a fine disregard for local law, Martin, J., sitting in Vermont, has considered the decision of *In re Garcewich* as establishing the law for the entire Second Circuit.[10] It has also been followed, with emendations, by Judge Ray in the Northern District of New York.[11]

§ 93. The authority of In re Garcewich in other circuits.

This decision of the Circuit Court of Appeals has been welcomed in other circuits as well. In Maine,[12]

[7] 176 Fed. 145, 23 Am. B. R. 314.

[8] 176 Fed. 145, 23 Am. B. R. 314.

[9] 174 Fed. 523, 23 Am. B. R. 172.

[10] *In re Hassam*, 153 Fed. 932, 18 Am. B. R. 745.

[11] *Pontiac Buggy Co.* v. *Skinner*, 158 Fed. 858, 20 Am. B. R. 206; *In re Carpenter*, 125 Fed. 831, 11 Am. B. R. 147.

[12] *In re Perkins*, 155 Fed. 237, 19 Am. B. R. 134.

North Carolina,[13] Oregon,[14] Iowa,[15] and Illinois,[16] the District Courts have given it their approval, based in part also, on the local law of the respective forums. The Circuit Court of Appeals, as well, of the Seventh Circuit, has given it unqualified approval in a case where the local law had not yet been established,[17] and in other cases as well, though ostensibly administering the local law.[18] Dietrich, J., sitting in the Iowa District, has condemned the withholding of a mortgage from record because of its natural tendency "to invite or encourage new or additional credit."[19] In the Eighth Circuit, on the other hand, the court, in a Wisconsin case, refused to follow *In re Garcewich* because, though the mortgage was not even recorded, yet the local law, as it was construed, allowed only attachment creditors a standing to object.[20] This mysterious distinction between creditors having attachments and those without once existed in New York, and was annulled when its consequences became apparent.[21]

§ 94. The pledge cases.

At the opening of this chapter *Casey* v. *Cavaroc*[22] was mentioned for the judicial opinion, there set

[13] *Mitchell* v. *Mitchell,* 147 Fed. 280, 17 Am. B. R. 382.

[14] *In re Rasmussen,* 136 Fed. 704, 13 Am. B. R. 462.

[15] *In re Hickerson,* 162 Fed. 345, 20 Am. B. R. 682.

[16] *In re Galt,* 120 Fed. 443, 9 Am. B. R. 682.

[17] *In re Gilligan,* 152 Fed. 605.

[18] *In re Rodgers,* 125 Fed. 169, 11 Am. B. R. 79; *In re Antigo Screen Door Co.,* 123 Fed. 249, 10 Am. B. R. 359.

[19] *In re Hickerson,* 162 Fed. 345, 20 Am. B. R. 682.

[20] *Dunlop* v. *Mercer,* 156 Fed. 545, 19 Am. B. R. 361.

[21] *Skilton* v. *Codington,* 185 N. Y. 80; *In re Economical Printing Co.,* 110 Fed. 514, 6 Am. B. R. 615; *In re Gerstman,* 157 Fed. 549, 19 Am. B. R. 145.

[22] 96 U. S. 467, Fed. Cas. 2,496.

forth, of the importance which the possession of property has in commercial affairs. The case is often cited merely for the narrow position that possession of the pledged property is essential to the validity of a pledge, as a common-law proposition.[23] As it now is, however, many recent decisions of the lower Federal courts have widened this rule so as to allow of a constructive possession by the pledgee, the actual possession being in the pledgor. These cases will be later discussed. Their immediate interest to us, however, is that they all utilize the true value of the rule of *Casey* v. *Cavaroc,* viz.: that the requirement of possession by the pledgee rests on no technicality of the law of pledge, but on the broader principle which governs the doctrines of reputed ownership, that the possession of property presumptively begets credit.

§ 95. The pledge cases, continued.

Thus, in *Phila. Warehouse Co.* v. *Winchester,*[24] the court propounds the theorem as "Did the steel company have the ostensible ownership of the pledged property?" And that question it answers with another, "Was that property so intermingled with or undistinguishable from its own unpledged property as to mislead and prejudice third persons and obtain for the steel company credit to which it was not entitled?" The correlative proposition, once already mentioned, that the presumption of reliance can be rebutted by the contrary presumption arising from constructive notice, is also here stated: "Due and reasonable care should be observed by the pledgee to negative the existence of ostensible ownership in the pledgor, and to this end such means should be re-

[23] *E. g.,* in *Nisbett* v. *Macon Bank,* 12 Fed. 686.

[24] 156 Fed. 600.

sorted to as fairly to inform or put third persons on inquiry." Such precautions had been taken, the court found, and so, the case being in equal scales, the transaction remained untouched. And so too, in *Dunn* v. *Train*.[25] In *Bush* v. *Export Storage Co.*,[26] on the other hand, where the bankrupt had been "clothed with the apparent ownership," the proper result followed, and the parties were not allowed to deny that the appearance was the reality.

§ 96. **Later cases — Fourth Circuit.**

A recent decision by the Circuit Court of Appeals, Fourth Circuit,[27] is even more emphatic. In that case an equitable lien was claimed on certain locomotives which had been delivered by the vendor to a construction company, and were in the active use and control of the latter when a receiver was appointed of its property under a creditors' bill. The court, in holding that this lien was unavailable, as against creditors of the construction company, because it had not been shown that the existence of this lien had been made known to the creditors of the construction company, said:

> "No citation of authority is requisite to support the proposition that such a secret lien could not avail against an attachment or execution creditor, not chargeable with knowledge or notice of its existence at the time of contracting his claim. It is equally clear that it is not necessary that it should appear that the creditor became such on the strength of the possession by

[25] 125 Fed. 221.
[26] 136 Fed. 918, 14 Am. B. R. 138.
[27] *H. K. Porter Co.* v. *Boyd*, 171 Fed. 305, 312.

> the debtor of the property attached or levied on and the presumption of absolute ownership arising from such possession."

The court there was speaking, of course, of persons who became creditors subsequently to the creation of this lien, because, in support of the proposition which it laid down as quoted above, the court proceeds to quote the language used in *Martin* v. *Mathiot*,[28] which has been quoted in another place,[29] to the effect that: "It rarely occurs that a man can prove what it was that induced him to give credit."

§ 97. Later cases — Eighth Circuit.

The Circuit Court of Appeals for the Eighth Circuit has lately adopted the same view:

> "The mortgagee, Bothe, by leaving the property in the possession of the bankrupt and withholding the mortgage from the record, invited others to deal with the bankrupt on his assumption of his ownership of an unincumbered title to the property conveyed. Whether those so dealing with him were actually deceived or not is immaterial. The inevitable tendency was to mislead and deceive, and the presumption must be indulged in that they were misled to their injury.[30]

[28] 14 Serg. & R. (Pa.) 214.

[29] § 63, *supra*.

[30] *Landis* v. *McDonald*, 88 Mo. App. 335; *Harrison & Calhoun* v. *South Carthage Min. Co.*, 95 Mo. App. 80, 68 S. W. 963, and cases cited; *In re Bothe*, 173 Fed. 597, 23 Am. B. R. 151.

CHAPTER X.

CIRCUMSTANCES IN REBUTTAL OF THE PRESUMPTION.

§ 98. Rebuttal by circumstances.

The presumption of reliance may be rebutted by circumstances as well as by more direct evidence that the creditors of the reputed owner were in fact not deceived. In other words, the real owner, instead of producing proof that the creditors really knew the true situation regarding the ownership of the goods, may rely upon certain facts attending the transaction, which reasonably may be supposed to have put the creditors on their guard. It is perhaps inaccurate to describe facts of such nature as this as being in rebuttal of the presumption of ownership. More exactly they prevent the presumption from arising. The court takes into consideration the same test of human experience which in another case would raise the presumption of reliance, and rules that, the circumstances being such, it is not to be supposed that the creditors relied upon any ostensible ownership.

§ 99. Illustration.

This is illustrated by the case of goods in the possession of a factor. As we have seen, it was, at an early date, settled that the placing of goods in a factor's hands for sale did not make him the ostensible owner in such wise as to estop the true owner in case of the factor's insolvency. But the English courts also very logically held, that, for any such favorable result to follow, the insolvent's status as a factor, and not as a merchant, must have been estab-

lished in the trade.[1] Hence if one doing a general business as a trader on his own account takes a special class of goods on consignment as a factor, the true owner must, in some wise, give notice to the public that, with respect to these goods, the insolvent is not a trader acting on his own account, and with his own property.[2]

§ 100. Methods of public notice.

The manner and means of giving such notice to the public have received judicial consideration in both England and America. In the main, they take one of two forms: (1) Signs displayed at the insolvent's place of business, indicating his nonownership of the goods in controversy; (2) the physical demarkation of the goods from the property of the insolvent, by means of labels placed on the goods, or their segregation. We do not here refer to those cases where the public record of an instrument affords constructive notice. These are discussed in another place.

§ 101. Signs at the bankrupt's place of business.

In neither of the two Federal cases found has this device proven effective. In *Ludvigh* v. *Am. Woolen Co.*[3] the bankrupt was a merchant who had done business, for many years, on his own account. The true

[1] *Ex parte White,* L. R. 6 Ch. App. 397; affd., *Towle* v. *White,* 29 L. T. (N. S.) 78; *Ex parte Bright,* 10 Ch. Div. 566; *In re Watson* (1904), 2 K. B. 753.

[2] *Ex parte Buck,* 3 Ch. Div. 795; *Ludvigh* v. *Am. Woolen Co.,* 159 Fed. 796, 19 Am. B. R. 795, 176 Fed. 145, 23 Am. B. R. 314, 19 Am. B. R. 795; *In re Garcewich,* 115 Fed. 87, 8 Am. B. R. 149; *In re Liberty Silk Co.,* 152 Fed. 844, 18 Am. B. R. 582.

[3] 159 Fed. 796, 19 Am. B. R. 795; 176 Fed. 145, 23 Am. B. R. 314, 19 Am. B. R. 795.

owner, doubting his standing, but wishing to use him as an outlet for its products, procured the incorporation of a company, of which substantially all the stock was held by the bankrupt. To the corporate entity, thus created, the true owner consigned a quantity of goods for sale. But though the name of the corporate consignee was posted at the bankrupt's store, adjacent to his own, this circumstance did not in the opinion of Hough, J., relieve the true owner from the claims of the bankrupt's creditors to the consigned goods. In *Ryttenberg* v. *Schefer*,[4] a similar case, the matter of the signs was thus discussed by Holt, J.:

> "I do not think that these signs indicated with any clearness who was the tenant or the actual occupant of the premises. If there were any distinction to be drawn, I should infer that it might be a little in favor of Radon & Co., who had occupied the premises before. They were apparently Radon & Co.'s principal place of business, and the term 'Annex' tended to indicate that they were used for some subsidiary purpose by Schefer, Schramm & Vogel. I think the signs are entitled to very little weight as evidence in determining who was in the possession and occupancy of the premises, and they certainly do not affirmatively establish that Schefer, Schramm & Vogel were in possession of the premises, and that Radon & Co. were not."[5]

On the other hand, the sign loomed large in an English case, for it really described the business. "Now, in the first place," says Jessel, M. R., "the debtors never held themselves out as the owners of the

[4] 131 Fed. 313.

[5] *Ryttenberg* v. *Schefer*, 131 Fed. 320, 11 Am. B. R. 652.

goods at all. They told all the world that they carried on business as 'merchants and manufacturers' agents,' those words were on their invoices and on their door, and there is no evidence that they ever described themselves otherwise. The result was that every one dealing with them knew that they had a business as agents, and this was no holding out without a foundation, for it is admitted that they really were agents, not only for the present appellants, but for other persons. It was their real business; they called themselves, not that which they were not, but that which they were. That being so, if a man says to his creditors, 'I carry on business as a merchant and factor,' can the creditors say 'I give you credit on the faith that any goods in your warehouse belong to you, not as a factor, but as a merchant?' The creditor knows that, by reason of the business carried on, the goods may not belong to the debtor, and it cannot be said that credit was given on the faith that the goods were his own. The description, 'merchants and manufacturers' agents,' was sufficient to let anybody know that the debtors had goods as agents, that the whole of the goods on their premises might in fact be there in that capacity."[6]

Doubtless a sign sufficiently well displayed at the debtor's place of business, properly framed and clearly worded, would constitute fair public notice. The difficulty in many cases, however, arises from the ambiguous wording, or intentional significance of the placards.

§ 102. The nature of the business.

The controversy cannot resolve itself into a question of signs if the nature of the business can speak for itself. As Lord Selborne, L. C., has said, "A custom known to the whole trade, and to all persons deal-

[6] *Ex parte Bright*, 10 Ch. Div. 566, 571.

ing with the trade surely is as well advertised, perhaps better advertised, than it would be by a notice posted over the door."[7]

§ 103. **Physical demarkation of the property.**

The practice of segregation of goods placed in the hands of one whose business is of such nature that his creditors might, in the absence of demarkation of some sort, consider the bailed property as the bailee's own, and extend credit on its faith, is of no recent origin. An instance of such a practice is reported as coming before Sir John Leach, M. R.[8] A case of frequent modern occurrence is where rolling stock is delivered under a so-called "car trust agreement." Those of the Bar whose practice has led them to the drawing or inspection of such agreements will recall the clause generally appearing in each of them, that each car delivered under the agreement shall, at all times until the conditions of hypothecation have been fulfilled, bear a plate with an inscription referring to the terms of the contract. A number of cases of this sort have appeared of recent years in the Federal Courts, where a pledgor was left in the possession of the pledged property. In all of these the question in each case was one of fact, whether, by means of signs upon the pledged property, or its segregation from the property of the pledgor "due and reasonable care had been observed by the pledgee to negative the existence of ostensible ownership in the pledgor."[9]

[7] *Ex parte Watkins,* L. R. 8 Ch. App. 520, 530.

[8] *Ex parte Marrable,* 1 Glyn & J. 402.

[9] *Phila. Warehouse Co.* v. *Winchester,* 156 Fed. 600; *Bush* v. *Export Storage Co.,* 136 Fed. 918, 14 Am. B. R. 138; *Dunn* v. *Train,* 125 Fed. 221; *Fourth St. Bank* v. *Milbourn Mills Co.,* 172 Fed. 177, 19 Am. B. R. 742; *In re Shaw,* 146 Fed. 273, 17 Am. B. R. 196; *Allen* v. *Hollender,* 128 Fed. 159, 11 Am. B. R. 753; *Security Warehousing Co.* v. *Hand,* 206 U. S. 415, 27 Sup. Ct. Rep. 720, 19 Am. B. R. 291.

§ 104. **Field warehousing.**

A system which has grown very widespread of late years is that of so-called field warehousing. A great number of decisions have been rendered on the validity of this system, both in the State and in the Federal Courts. The entire doctrine on the subject, however, as gathered from these decisions reduces itself to the simple proposition that while there may well be a constructive delivery to a pledgee to validate a pledge of personal property, yet if the pledgor who thus actually retains the possession of the property does not separate it and maintain its segregation from property of his own by a sufficiency of indicia to the public, the pledge will be disregarded as against the claims of the pledgor's creditors. In all of these cases the question is one of fact whether the system of segregation pursued has been sufficient to "negative the existence of ostensible ownership in the pledgor."[10]

§ 105. **Its relation to true business.**

This system of constructive delivery of pledged property is necessary in a large class of cases under modern conditions where a lien is created on heavy and bulky property, which in the meantime it is necessary that the pledgor have near at hand in order that the honest purposes of the parties may be fulfilled. The most frequent instance is where the output of a

[10] *Security Warehousing Co.* v. *Hand,* 206 U. S. 415, 27 Sup. Ct. 720; *In re Rodgers,* 125 Fed. 169, 11 Am. B. R. 79; *Bush* v. *Export Storage Co.,* 136 Fed. 918; *Phila. Warehouse Co.* v. *Winchester,* 156 Fed. 600; *First Natl. Bank* v. *Penn. Trust Co.,* 124 Fed. 968; *Dunn* v. *Train,* 125 Fed. 221; *American Pig Iron Co.* v. *German,* 126 Ala. 194; *Ayres* v. *McCandless,* 147 Pa. 49; *H. K. Porter Co.* v. *Boyd,* 171 Fed. 306; *Fourth St. Bank* v. *Milbourn Mills Co.,* 172 Fed. 177, 19 Am. B. R. 742.

mill is hypothecated to one who advances money for the season's operating expenses, or where machinery is being built and part or all the raw material which enters into its construction is pledged to secure an advance for the operation of the foundry. The courts allow such transactions if they are honest in their inception and if sufficient care is taken that the public be not deceived.

§ 106. Illustrative cases.

Thus in *American Pig Iron Co.* v. *German*,[11] a quantity of pig iron was pledged and left on ground belonging to the pledgor, a furnace company. It was located apart from the other iron and painted with the pledgee's initials. This segregation was held sufficient. Likewise in *Ayres* v. *McCandless*,[12] lumber piled in the mill yard of the vendors and so marked was held to be properly segregated for the purposes of the vendee.

So in *Phila. Warehouse Co.* v. *Winchester*.[13] The warehouse company loaned money to the bankrupt company, taking from it as collateral leases of portions of its premises on which goods intended as security were situated. The warehouse company appointed a custodian of the leased premises and of the property. The custodian maintained possession and continuously maintained on the property in a number of conspicuous positions signs and placards which indicated that the warehouse company was the only one specially interested in the pledged property. The bankrupt also had some of its own property on these premises. But as the court says, this operated if any-

[11] 126 Ala. 194.
[12] 147 Pa. 49.
[13] 156 Fed. 600.

thing to the detriment merely of the bankrupt, because the public would most probably assume that all the property within the inclosure was pledged, including the unhypothecated stock of the bankrupt, instead of believing that none of the property was under lien.

In *First National Bank* v. *Penn. Trust Co.*[14] the facts were the same as in *Phila. Warehouse Co.* v. *Winchester,*[15] but during part of the time the signs were not on the property. This, however, was not the fault or done with the consent of the lienor, and so his rights were not thereby affected. The court said:

> "It is not suggested that the bank had any knowledge of the removal of the signs or that it did not replace them so soon as their removal was brought to its notice. The effect of a remarking of the billets was not to create a new lien or to acquire a preference for an antecedent debt between the parties."

The good faith of the lienor in this case was apparent and so its rights were vindicated.

§ 107. Illustrative cases continued.

The courts have gone a step further than this, and have held that even if the custodian of this segregated property is a joint employee of the lienor and the bankrupt the hypothecation is nevertheless valid.[16] As the Circuit Court of Appeals, First Circuit, has said, this sufficiently shows "that the goods are actually set apart in the keeping of the special bailee with authority to notify third persons that they are

[14] 124 Fed. 968.

[15] *Supra.*

[16] *Dunn* v. *Train,* 125 Fed. 221; *Sumner* v. *Hamlet,* 12 Pick. 76.

held in pledge and to remove the goods if found necessary for the safety of its principal."[17] But the bankrupt himself cannot be the custodian, because obviously there is nothing in such a case to rebut the natural presumption.[18]

§ 108. **The system lawful if properly safeguarded.**

Bush v. *Export Storage Co.*[19] contains a most elaborate description and discussion of this field storage system, as properly used, which one may read with the greatest profit. The system itself, as the learned judge there says, "would be good if properly and carefully maintained in its essential details." The objection in that case was that the requirements were not properly observed.

§ 109. **Security Warehousing Co. v. Hand.**

In *Security Warehousing Co.* v. *Hand*,[20] on the other hand, the court was called upon to deal with a scheme which used the field warehousing system merely as a cloak, no precaution as to safeguarding the public having been required or adopted.

The contest there was over the possession of certain property between the trustee of the Racine Knitting Company and the appellant, the Warehousing Company, which was a New York corporation engaged in the so-called business of "field warehousing" in Wisconsin. It occupied no warehouse of its own, but leased certain premises from the knitting company at Racine. This place was occupied by the knitting company with its goods to be sold, and the

[17] *Dunn* v. *Train*, 125 Fed. 221.
[18] *In re Shaw*, 146 Fed. 273, 17 Am. B. R. 196.
[19] 136 Fed. 918, 14 Am. B. R. 138.
[20] 206 U. S. 415; 29 Sup. Ct. Rep. 720.

goods were placed on the premises really occupied by the knitting company, although in form leased by it to the warehousing company. So-called warehouse receipts were given to the knitting company by the warehousing company, acknowledging the receipt of the property at such place. These receipts were in turn pledged by the knitting company to various banks. It was held that the trustee of the knitting company was entitled to the property on hand. Mr. Justice Peckham, who delivered the opinion, says:

> "It is a trifling with words to call the various transactions between the knitting company and the warehousing company a transfer of possession from the former to the latter. There was really no delivery and no change of possession, continuous or otherwise. The alleged change was a mere pretense and sham. * * * The security company gave no evidences to the passer-by, no business was sought from the public, the only property within the inclosures was the knitting company's. The knitting company did not want storage room, but collaterals, which the security company agreed to furnish for a commission upon the amount thereof, plus all expenses. The security company's only agents on the scene were the agents of the knitting company, who cared for and shipped out its goods. That this was the only business contemplated is disclosed by the agreement that the knitting company should be restored to full possession of the premises at any time it returned the outstanding receipts. This, in our judgment, was not warehousing within the law of Wisconsin. * * * So far from the security company maintaining an open, exclusive,

unequivocal possession during the two years this arrangement was carried on, it seems that the security company might as well have been eliminated and the knitting company have employed its own stock-keepers and shipping clerks as custodians for intending lienors directly instead of indirectly through the security company. In that view this becomes one of the cases 'in which the exclusive power of the so-called bailee'[21] tapers away to nothingness."[22]

§ 110. Fraud in fact there involved.

The Supreme Court treated this transaction as one of fraud in fact. Speaking of the difference between a mere failure to record a mortgage under a State law where no fraud was alleged as in *In re Antigo Screen Door Co.*[23] and the present case, the court said:

> "The case illustrates the distinction taken between fraud in fact and the mere failure to file a mortgage otherwise valid against the world."

In *Security Warehousing Co.* v. *Hand*,[24] it was held that so-called warehouse receipts which were issued by the bankrupt to secure a creditor covering property in the bankrupt's possession, but which was in no wise set apart and identified as the property represented by the receipts, were invalid as against a trustee in bankruptcy. The court said:

> "The title to this property was in the knitting company. There had been no valid pledge of it,

[21] *Union Trust Co.* v. *Wilson*, 198 U. S. 530.

[22] *Drury* v. *Moores*, 171 Mass. 252; *Tradesmen's National Bank* v. *Kent Mfg. Co.*, 186 Pa. 556.

[23] 123 Fed. 249, 10 Am. B. R. 359.

[24] 206 U. S. 415, 29 Sup. Ct. Rep. 720.

because the possession had been at all times in the knitting company, and it could have been levied upon and sold under judicial process against the knitting company at the time of the adjudication in bankruptcy."

§ 111. Fourth St. Bank v. Milbourn Mills

In *Fourth St. Bank* v. *Milbourn Mills*,[25] a bankrupt milling company issued grain certificates, each calling for a certain quantity of wheat or flour stored in its grain tanks or mill, to be delivered to the holder on demand. A number of these securities it hypothecated for a loan. It was held by the Circuit Court of Appeals, Third Circuit, that these certificates conferred no lien as against the trustee in bankruptcy of the milling company. Archbald, J., who delivered the opinion, thus referred to the facts respecting segregation:

"The present case arises out of an attempt, by the bankrupt, a milling company, to pledge its property for money advanced, while still retaining possession and dominion over it. The form adopted was the issuing of so-called 'certificates,' for so much grain or flour, in store at the mills; these certificates being issued to different parties, as collateral to loans, somewhat like ordinary warehouse receipts. The grain in question was contained in tanks, adjoining the mills, from which it was run to the mills, to be made into flour, by means of a conveyor, by simply unlocking a slide. It was drawn upon freely, in this way; no definite quantity being kept on hand, and there being no special arrangement with the hold-

[25] 172 Fed. 177, 19 Am. B. R. 742.

ers of certificates, with regard to it, except that it was not to be reduced beyond the amount called for thereby. The fact is that it was a shifting quantity, sometimes running far below this, although sometimes possibly above it; there being certificates outstanding at the time of bankruptcy for 138,000 bushels, while there were but 83,000 bushels on hand. The difference is ascribed to the depredation of insects, by which the grain became heated and lost weight; but it is difficult to see how 55,000 bushels could have disappeared in that way. Nor is it material, the fact being, from whatever cause, that it was not there.

"The arrangement with regard to the flour was somewhat similar. It was stored in barrels in the basement of the company's warehouse under the charge of the superintendent, in three sections, two of 200 barrels each, and one of 800 barrels, divided off from each other, by upright posts, and all bearing a certain common brand. There was also a sign that it was not to be touched by an employee; but, aside from what this might vaguely imply, there was nothing to indicate that there was any control or ownership over it other than that of the bankrupt company in whose possession it was. Differing from the grain, there was no change in the quantity of the flour from the start, and certificates for the whole 1,200 barrels were issued to the one bank."

§ 112. Sholes v. Asphalt Co.

The case of *Sholes* v. *Asphalt Co.*[26] is cited by Archbald, J. In that case the Asphalt Company attempted to pledge certain asphalt blocks which were stored in

[26] 183 Pa. St. 528.

the pledgor's yard. Nothing was done to carry the pledge into effect. The goods were not separated, marked, or in any way distinguished from the other assets of the company. It was held that the pledge was invalid as against a receiver appointed on a creditors' bill. "Even in such cases," says Fell, J., viz.: of constructive delivery, "the want of constructive or symbolical delivery or of some act whereby the goods pledged may be distinguished and set apart from the other goods in the possession of the pledgor has not been excused."

§ 113. **Confusion of goods.**

Of course the insolvent may properly be put in possession of goods not his own if they are sufficiently separated from his own stock by signs or tags. But this separation must be real and not merely formal. Tagging the goods with the owner's name is sufficient, if properly done.[27] The most obvious case to the contrary by way of illustration recently arose in Maine, where, the bankrupt being made the custodian of the pledged goods, they were tagged with initial letters, which, by the understanding between the parties, indicated that the marked goods belonged to the claimant. But as against the creditors of the bankrupt, who possessed no cypher for these signals, it was held that the goods belonged to the bankrupt.[28] In a New York case, where the goods of the consignee, though perhaps tagged with the owner's trade symbol, were, with the true owner's consent, so mingled with the stock in trade of the bankrupt that only a close scrutiny could enable one to discriminate between the consigned property and the bankrupt's stock, it was

[27] *Allen* v. *Hollender*, 128 Fed. 159, 11 Am. B. R. 753.
[28] *In re Shaw*, 146 Fed. 273, 17 Am. B. R. 196.

held that the trustee of the bankrupt took title as against the true owner.[29] And the same result was reached in the Seventh Circuit, where, "upon each pile of bags of seed for which the warehouse receipts or warrants were issued there was placed a small tag, which might be discovered upon careful search."[30]

§ 114. Loans on bankable documents of title.

Of course, cases of this sort must be distinguished from the numerous cases where the dealings in documents of title to goods in transit or on storage are recognized.[31] In these cases there is no question as to the segregation of the goods. They are sufficiently segregated by being in the hands of a third party. This distinction is so obvious as not to require mention were it not for the interesting case of *National Bank* v. *Rogers*,[32] which, were it not for this thought, would appear of doubtful soundness. In that case S. & Company borrowed money from the plaintiff, giving a note which recited that they had deposited with the plaintiff as collateral certain goods. S. & Company at the same time gave the plaintiff a paper whereby they acknowledged receipt of the merchandise from the plaintiff and agreed to hold the goods in trust for him, and to give him the proceeds in case of sale. The goods at that time were in the custom house. S. & Company took possession of the goods. While these chattels still remained among S. & Company's general mass of merchandise they were taken

[29] *Ludvigh* v. *Am. Woolen Co.*, 176 Fed. 145, 23 Am. B. R. 314.

[30] *In re Rodgers*, 125 Fed. 169, 11 Am. B. R. 79.

[31] *E. g. Dows* v. *The Bank*, 91 U. S. 618. A full discussion of this subject will be found in *Charanay* v. *York Silk Co.*, 170 Fed. 819.

[32] 166 N. Y. 380.

possession of by an assignee for the benefit of creditors. It was held that the plaintiff was entitled to the property, the court saying:

> "Effect can be given to the intention of the parties by holding Sholes & Company strictly to the letter of their contract."

This was quite right, because it was not the plaintiff's fault that S. & Company had not segregated the goods. At the time he made his contract with them the goods were segregated by being in the custom house, and in the absence of proof that the plaintiff had agreed to allow S. & Company to mingle the goods with their own he was entitled to them, even against S. & Company's creditors.

§ 115. Customs of trade entitled to weight.

The courts must take into account, in all such cases, the customs of trade. For instance, the custom is common with us for a small grocer to hire his coffee-roasting machine. No creditors of any such tradesman ever became such on account of his possession of a machine whose cost would be out of proportion to the value of his stock in trade. Now, if the court before whom such a case should come were not familiar with this custom, it would be necessary to prove it. But if such a custom, in a particular trade or locality, had been proven several times before the court, it would, in subsequent cases, be the latter's duty to take judicial notice of the existence of the particular custom. That is the English view, and it is supported by many interesting instances and discussions. Thus, in *Ex parte Hattersley*[33] the custom

[33] 8 Ch. D. 601.

of selling pianos on the installment plan was proven. So a local custom of Liverpool wine merchants was proven.[34]

§ 116. Same subject, continued.

In *Crawcour* v. *Salter*,[35] the Court of Appeal approved the view of Malins, V. C., that the custom of reserving title to furniture supplied a hotel is so well known that creditors should have known it. This was previously doubted by the Court of Appeal.[36] But in *Crawcour* v. *Salter*, Lush, L. J., says: "The custom referred to is now so well known that I think the court ought to take judicial notice of it. No person dealing with a hotel-keeper ought to assume that the furniture belongs to him."

§ 117. Same subject, continued.

"There is no doubt," says Mellish, L. J., for the court,[37] "that a mercantile custom may be so frequently proved in courts of common law that the courts will take judicial notice of it, and it becomes a part of the law merchant; and we see no reason why the same rule ought not to prevail in the Court of Bankruptcy. It seems a useless expense to require parties to prove by a large number of witnesses a custom which has been proved over and over again." But in that case the court refused to take judicial notice. The test is, according to the Lord Justice, whether the custom "has been proved in the Court of

[34] *Ex parte Watkins*, L. R. 8 Ch. App. 520.
[35] L. R. 18 Ch. D. 30.
[36] *Ex parte Powell*, 1 Ch. D. 501.
[37] *Ex parte Powell*, 1 Ch. D. 501.

Bankruptcy in so many instances that the court ought now to take judicial notice of it."

§ 118. Same subject, continued.

Then, when we come to proof of the custom, the question simply is whether it has been "proved to have existed so long, and to have been so extensively acted upon, that the ordinary creditors of the debtor in his trade may be reasonably presumed to have known it."[38]

[38] Mellish, L. J., *Ex parte Powell,* 1 Ch. D. 501, 508.

CHAPTER XI.

REPUTED OWNERSHIP OF CHOSES IN ACTION.

§ 119. Reputed ownership possible in such cases.

In *Ryall* v. *Rowles*[1] the bankrupt mortgaged his interest in a partnership. It was held that although this case did not fall within the Statute of Reputed Ownership because the mortgage in part was of a chose in action, viz., the book accounts of the partnership, yet it came within the spirit of the statute, and equity following the law would hold the mortgagee estopped to assert his title against the creditors of the mortgagor. There a true case of reputed ownership existed. The partnership assets consisted as usual of tangible property and accounts receivable. The partners to outward appearance owned all the property thus constituted. The reputation of ownership was just as complete with respect to any one asset of the partnership as any other, and no distinction could justly be drawn to which a court of equity would willingly listen between the book accounts and the stock in trade. So, too, as we shall see, with the cases concerning the after-acquired property clause of the modern corporate mortgage. There it will be perceived that the book accounts of the mortgagor are considered as constituting in part an ostensible asset for the inducement of credit.

§ 120. But not so common.

The mention of such cases should remove from our minds any impressions which the decisions now to be

[1] Ves. Sr. 346.

discussed may create, that the law of reputed ownership can in no case operate with respect to choses in action. Its application to intangible property is not at all barred by the nature of the property. On the other hand, the nature of the dominion asserted over choses in action is in many cases so different from the features attending the possession of land or chattels as to afford fewer instances of ostentation of ownership.

§ 121. The difficulties of the English statute.

It must be confessed that the reputed ownership clause, as it appeared in the successive English Bankruptcy Statutes, was not so discriminating. As Lord Justice Vaughan Williams has noted in his edition of the Bankrupt Act,[2] " generally, however, as under the words, ' goods and chattels ' all personal estate, stock, bonds, notes, money. plate, furniture, etc., are included; so every sort of personal estate, except chattels real and annuities have been held to be within these words in the bankruptcy statutes," and then follows an extensive catalogue of items. It must be noted, however, that under the present act of 1883, section 44, " things in action other than debts due or growing due to the bankrupt in the course of his trade or business are no longer within the doctrine of reputed ownership."[3]

§ 122. The question more open with us.

In America the question has been left more open for the discussion of the courts by the absence of any legislation on the subject of reputed ownership other

[2] Williams on Bankruptcy, (8th ed.), pp. 218–9.

[3] Williams op. cit. p. 219.

than the provisions for the filing of chattel mortgages and conditional bills of sale, to which we have already adverted. The New York courts long since were called upon to consider whether these statutes applied to the pledge or mortgage of choses in action, and they unhesitatingly gave a negative answer.[4]

Then came, as was to be expected, this question — Does such a case fall within the doctrine of reputed ownership?

§ 123. **The general rule.**

Both the State and Federal courts within the Second Circuit were unanimous in declining to apply the doctrine to the cases before them.[5] The reason for this unanimity finds apt expression in the opinion delivered by Ward, J., in *Sexton* v. *Kessler:*

> "There was, however, as to the securities under consideration no secrecy which was not inherent in their nature. The public does not know what stocks, bonds, or notes a merchant has, and, therefore, does not give him credit because of them."

"Every pledge of securities," as was said by Nash, J.,[6] "may be, and generally is, done in secret. The dealings had with mercantile houses are always with knowledge that available bills and accounts receivable may be so used as to procure credit on capital."

[4] *Booth* v. *Kehoe,* 71 N. Y. 341; *Bank* v. *Chaskin,* 28 App. Div. 315; *Stackhouse* v. *Holden,* 66 App. Div. 423.

[5] *Sexton* v. *Kessler,* 172 Fed. 535, 21 Am. B. R. 807; *Young* v. *Upson,* 115 Fed. 192, 8 Am. B. R. 377; *Stackhouse* v. *Holden,* 66 App. Div. 423.

[6] *Stackhouse* v. *Holden,* 66 App. Div. 423.

§ 124. **The reason.**

The rules of law applicable to the transfer of goods as distinct from chattels differ. "As to the one," says the court,[7] " the possession of which is an evidence of ownership, the dealings must be open, visible and public; while as to the other the business may be, as it usually is, private."

In other words, in the ordinary case of a sale or hypothecation of a chose in action, the courts, in the cases cited, refused to enforce any general rule of presumption such as we saw applied in the cases of tangible property. That there is such a rule, and that the sole question before them was its enforcement or withholding, each court, in the two cases last cited, distinctly recognizes.

Judge Ward's language, in *Sexton* v. *Kessler,* is this: " The visible possession of chattels apparently owned by the possessor creates a wholly different situation. In respect to such property the law prohibits secret liens against creditors." Shall this general rule of presumption apply to the ordinary case of a secret hypothecation or sale of choses in action? No, says the court, and why? Because of another general principle, drawn from the same source, the judicial knowledge of human affairs, " The public does not know what stocks, bonds, or notes a merchant has and, therefore, does not give him credit because of them,"[8] To the same effect is the language of the New York court, that any attempt to apply fixed rules for the transaction of the business would interfere with this undoubted right, derived from " the necessities of business," to have transactions in choses in action kept private.[9]

[7] *Stackhouse* v. *Holden,* 66 App. Div. 423.

[8] *Sexton* v. *Kessler,* 172 Fed. 535, 21 Am. B. R. 807.

[9] *Stackhouse* v. *Holden,* 66 App. Div. 423; approved in *Young* v. *Upson,* 115 Fed. 192, 195, 8 Am. B. R. 377.

§ 125. **Registration does not change the result.**

Nor would the registration of such choses in action as bonds, or stock, seem to effect any different result. Shares of stock are universally transferable only by registration on the books of the company to whose assets they relate. The usual form of bonds or debentures dealt in on the New York or London 'changes are, by their terms, transferable to bearer unless registered on the books, either of the company or of the trustee under the mortgage; and, in event of their registration, are transferable only by a new process of registration. The question whether, if the true owner of stock or bonds, transferable only by registry, is estopped to assert his ownership by leaving the record title in the bankrupt's name, has been answered in the negative by the House of Lords.[10] "Any inquiry as to what had become of the certificates," said Lord Blackburn, "would (unless the bankrupts were fraudulent liars, which we have no right to assume) have led to the disclosure of the fact that they were pledged."

§ 126. **The rule not universal.**

Of course, it should be remembered that these courts were not denying the possibility of an estoppel in cases where choses in action were concerned. All they did was to withhold help from the creation of an estoppel, by the rule of presumption of whose existence, in the case of tangible chattels, they were plainly aware. If, unaided by this rule, the complaining creditors could prove an estoppel anyhow, they would have their reward. "There is no evidence," Ward, J., is careful to say in *Sexton* v. *Kessler*,[11]

[10] *Colonial Bank* v. *Whinney*, 11 A. C. 426.

[11] 172 Fed. 535, 21 Am. B. R. 807.

" that any exhibition of, or statement as to these securities was made to any one by the New York house for the purpose of obtaining credit." And likewise with the courts in *Stackhouse* v. *Holden*[12] and *Young* v. *Upson*,[13] the extent of their action was merely to preclude the application of the " fixed rules " on which the complainants placed sole reliance.

§ 127. Sexton v. Kessler and Girard Trust Co. v. Mellor.

Apparently against this current of authority stands *Girard Trust Co.* v. *Mellor*,[14] which is very much like *Sexton* v. *Kessler*.[15] There certain Philadelphia bankers, desiring to secure the underwriters to a venture, inclosed in an envelope certain notes and bonds which, with a list of the persons intended to be protected, they placed in a tin box. This box they deposited with a safe deposit company, the package being properly indorsed. It was held that this deposit was invalid as against the bankers' creditors. The court seems to base its decision upon the ground that there had not been a delivery of the pledged property. In *Sexton* v. *Kessler*, on the other hand, a New York banking house, under an arrangement to that effect with an English house, placed certain securities transferable by delivery in an envelope in its safe deposit vaults, marked as an escrow for the account of the English house. From time to time these securities were replaced by others, in each instance the English house being notified. The object of the arrangement was to protect the English house against drawings

[12] 66 App. Div. 423.
[13] 115 Fed. 192, 8 Am. B. R. 377.
[14] 156 Pa. St. 579.
[15] 172 Fed. 535, 21 Am. B. R. 807.

by the New York establishment. It was held that the English house had a valid equitable lien upon the securities. The learned judges differed somewhat in their use of technical language in describing the transaction. The leading opinion of Ward, J., has already been mentioned. But attention should not be diverted from the following language of Noyes, J.:

> "In considering the case from any point of view one thing is apparent from the outset, and that is the good faith of the parties. Another thing is also apparent — the New York house intended that the securities in question should afford protection to the Manchester house for their acceptances, and the latter supposed that they were obtaining protection. Both parties acted upon the assumption that that which they did accomplished something. The New York house furnished security in the form desired by the Manchester house, and the latter accepted the former's drawings upon that security. The transaction, if invalid, is only so because in contravention of some stated or positive legal principle; and it cannot be declared invalid without inflicting great hardship upon the Manchester house."

In the Pennsylvania case, on the other hand, what the bankers did was not in pursuance of any existing contract, written or otherwise. It was a mere gratuitous attempt at a preference, and the court could have condemned the transaction, if on no other ground, on that of bad faith, to say nothing of the fact that a constructive delivery in the case of a pledge is only allowed when there is an express agreement to that effect, which could hardly be where the pledgee knew nothing of the attempt.

CHAPTER XII.

REPUTED OWNERSHIP AND THE RECORDING ACTS.

§ 128. Recording acts.

As we have seen, the statutes of the various States require chattel mortgages and conditional sale agreements, where the debtor remains in possession of the bargained property, to be filed in public office. Similar statutory provisions are now in force in England.[1]

§ 129. Their extension of the estoppel principle.

It is interesting to note that in this respect the modern statutory policy of both countries has extended rather than restricted the principle of the Statute of Reputed Ownership. Under that statute, as we have seen, the creditors of an insolvent trader could not attack a conditional sale agreement, where the possession remained with the debtor, if it was so provided in the agreement between himself and the vendor.[2] Such is the law in all but a few States of this country, notable among these exceptions being Illinois and Pennsylvania.[3] And so, too, is a chattel mortgage valid at common law, though the mortgagor remains in possession.

In both countries, on the contrary, the principle of making public the nature of one's possession has been extended by statute, so as to bring within its pale

[1] Bill of Sales Act, 17 & 18 Vict. Ch. 36, 41 & 42 Vict. Ch. See *Cookson* v. *Swire*, L. R. 9 A. C. 653.

[2] *Martindale* v. *Booth*, 3 B. & Ad. 498; *Harkness* v. *Russell*, 118 U. S. 670, 7 Sup. Ct. Rep. 51.

[3] See the opinion in *Harkness* v. *Russell*, 118 U. S. 663, 7 Sup. Ct. Rep. 51, for a review of the various State decisions.

these very instances, which were not affected by the Statute of James.

§ 130. Liberal rule of construction.

The policy which thus finds expression has been given added vigor by the liberal rules of construction adopted in such cases by our courts. The result of many decisions in New York on this point has thus been summarized:

> "The statute has been construed in favor of creditors along the broadest lines and in accordance with the most liberal principles of statutory construction. Technicalities have given way to equities; limitations to liberality. The statute contemplates the protection of creditors against secret arrangements to withhold the filing of chattel mortgages. It commands publicity."[4]

Considerable interest, therefore, must attach to the remarks of Vann, J., in the latest case on this subject, where the learned judge says that, if the New York statute requiring the filing of chattel mortgages were not thus liberally construed, "no one could safely give credit on the faith of the possession and the apparent ownership of personal property; for the title might be in some person unknown, and the possession that of lessee merely."[5]

§ 131. Misunderstandings of the New York statute.

The statute of New York regarding the filing of conditional bills of sale and chattel mortgages was

[4] *Tooker* v. *Siegel Cooper Co.*, 194 N. Y. 442; *Karst* v. *Gane*, 136 N. Y. 316; *Dickinson* v. *Oliver*, 195 N. Y. 238, 247-8.

[5] *Dickinson* v. *Oliver*, 195 N. Y. 238, 247-8.

for sometime not clearly understood by the courts of that State. That the omission to file such an instrument would render it void as against creditors would seem to have been the clear meaning of the statute. But for a long period the decisions of the New York courts were in apparent conflict as to whether a creditor, in order to treat an unfiled mortgage as a nullity, must first have secured a judgment upon his claim. Upon the belief that such was the law of New York, the Federal Circuit Court of Appeals for the Second Circuit held that a trustee in bankruptcy could not treat an unfiled chattel mortgage, given by the bankrupt who remained in possession of the property, as a nullity, except for the benefit of such creditors as may have secured judgments upon their claims prior to the adjudication of bankruptcy.[6] Later the New York Court of Appeals held that this view of the law was erroneous, and that the statute's benefits extended as well to simple creditors as to those holding judgments.[7] Its error in interpreting the law of the forum being thus explained, the Circuit Court of Appeals gracefully retracted it.[8] The incident furnishes but another instance of the frequent embarrassments that arise in our system of two separate judicial hierarchies, one of which is authorized to expound the local statutes, while the other must grope as it may for their true meaning.

§ 132. Test of good faith easily applicable.

With such a State statute the question of good faith is easily to be solved in cases of the kind under re-

[6] *In re N. Y. Economical Printing Co.*, 110 Fed. 514, 6 Am. B. R. 615.

[7] *Skilton* v. *Codington*, 185 N. Y. 80.

[8] *In re Gerstman*, 157 Fed. 549, 19 Am. B. R. 145.

view. If it is agreed between the parties that the mortgage shall be withheld from record, then if any creditors, in ignorance of the existence of the mortgage, extend credit to the mortgagor, who remains in possession of the property, there can be no doubt that the courts will not allow the mortgagee to assert his rights until the claims of those creditors have been satisfied.[9]

> "Such performances or acts," as the Kentucky court long ago said, "though not designed to perpetrate an actual fraud upon other persons, have an unavoidable tendency that way, and are obviously opposed to the general policy of the law regarding the public registration of all liens and incumbrances upon property permitted to be retained and claimed by debtors."[10]

§ 133. Completeness of the statute's application.

In the case of a statute which renders void as against creditors an unrecorded or unfiled conveyance by way of security where the debtor remains in possession, there is little for the courts to consider. The statute itself expresses its own policy and its own rule of estoppel, just as did the English Reputed Ownership clause. Such is the case in New York with regard to unfiled mortgages and conditional bills of sale. A more interesting field of investigation is open under the statutes of some of the States which do not

[9] *Lyon* v. *Council Bluffs Savings Bank,* 29 Fed. 566; *Cragan* v. *Carmichael,* 2 Dill. 519; *Crooks* v. *Stewart,* 7 Fed. 800; *Argall* v. *Seymour,* 4 McCrary 35, 48 Fed. 548; *Simon* v. *Oppenheimer,* 20 Fed. 553; *Rumsey* v. *Towne,* 20 Fed. 558; *Wells* v. *Langbein,* 20 Fed. 183; *Maish* v. *Bird,* 22 Fed. 576; *Hilliard* v. *Cagle,* 46 Miss. 309.

[10] *Hildeburn* v. *Brown,* 17 B. Mon. 779.

render such instruments void in any event as against creditors, but leave the question open to be adjusted by the principles of equity administered by the courts.

§ 134. **Examples.**

Such cases are afforded, for example, under the various State statutes requiring the registration of real estate conveyances. In no State, so far as we know, does the statute render an unrecorded conveyance void as against anybody but an innocent purchaser for value of the property itself. Yet, as Chief Justice Marshall long ago pointed out,[11] the very existence of such statutes may afford opportunities for the ostentation of ownership by the simple expedient of withholding deeds from record, and leaving one not the real owner in possession of the property. In later times such cases actually arose and the courts uniformly applied the doctrine of estoppel.[12] The doctrine of reputed ownership as expounded in this country is well stated in the case of *Sloan* v. *Huntington*,[13] by Landon, J.:

> "The learned trial judge thought that the wife was not bound to anticipate that the husband would make false representations as to his interest in that property. That may be so as to express false representations. But the deed was recorded and the wife does not deny her knowledge of that fact. And knowing that, she knew that the record constantly bore witness as to her husband's credit."

[11] *Sexton* v. *Wheaton*, 8 Wheat. 229.

[12] *Hilliard v. Cagle*, 46 Miss. 309; *Water's Appeal*, 35 Pa. St. 523; *Pierce* v. *Hower*, 142 Ind. 626; *Minnich* v. *Schaffer*, 135 Ind. 634; *City Bank* v. *Hamilton*, 34 N. J. Eq. 159; *Trenton Banking Co.* v. *Duncan*, 86 N. Y. 221; *Wolsey* v. *Henn*, 85 App. Div. 331; *Sloan* v. *Huntington*, 8 App. Div. 93.

[13] 8 App. Div. 93.

And as was said by Van Fleet, V. C., in *City Bank* v. *Hamilton:*[14]

> "If a wife permits her husband to take title to her lands and to hold himself out to the world as the owner of them, and to contract debts upon the credit of such ownership, she cannot afterward, by taking title to herself, withdraw them from the reach of his creditors, and thus defeat their claims."

§ 135. The question the same here as in the other cases.

The question is the same in such cases as in all the others, whether the one who was not the real owner was nevertheless held out in that light by his possession of the property and the exercise of acts of ownership with respect thereto. But this is a question of fact to be decided in accordance with the settled principles which have been discussed. No such transaction, unless a statute pronounces it void, can be declared so as matter of law. The question in every case is one of fact.

§ 136. Hilliard v. Cagle explained.

This point is well emphasized by the Supreme Court of Mississippi. In *Hilliard* v. *Cagle,*[15] the court properly held that a case of ostentation of ownership existed. But certain expressions therein used evidently led the Mississippi bar to regard the case as deciding that in any instance where one not the

[14] 34 N. J. Eq. 159.
[15] 46 Miss. 309.

true owner of property, yet remains apparently such by the latest conveyance being secreted from record, he, as matter of law, must be taken as the owner as against the world, no matter what were the additional circumstances of estoppel or otherwise. In a later case,[16] the court despoils the bar of its erroneous belief.

> "This appeal," said Campbell, C. J., "presents another instance of the misleading influence of *Hilliard* v. *Cagle*,[17] a case valuable only as showing a state of facts which led the court to the conclusion that the scheme then condemned was fraudulent as to subsequent creditors. In so far as it may be deduced from the opinion in that case that the withholding from record of any instrument which by law is good as to third persons not having notice only from the time of its being filed for record is anything more than a circumstance to be considered on the question of fraud, we have corrected that error in *Klein* v. *Richardson*,[18] where the announcement is made that one who fails to record an instrument simply takes the risk of a supervening right to or lien on the land or other thing."

And later on in the same opinion the keynote is thus sounded:

> "The law does not require a proclamation of debts or credit. It only requires good faith and it does not denounce as bad faith confidence reposed between debtor and creditor."

[16] *Day* v. *Goodbar*, 69 Miss., 687, 12 So. Rep. 30.
[17] 46 Miss. 309.
[18] 64 Miss. 41.

§ 137. Transaction not "fraudulent in law."

It is, indeed, a confusion of ideas to say that a transaction of this kind can be fraudulent in law. To denounce a transaction as sham does not help much to the ascertainment of why it is sham, and recalls only the impatient remark of Bramwell, L. J., that he could not understand the difference between what the bar termed "legal fraud" and actual fraud, any more than he could grasp a distinction between legal heat and legal cold, or legal light and legal shade.[19] So in *Banks* v. *Klein*[20] it was held that no estoppel existed against a woman who took a deed from her son covering his indebtedness to her, but did not record it. The court said:

> "Had the transactions been between strangers who had never before had such intimate business relations, the presumption would have been much stronger; but a change of the confidential business relations which had existed between Mrs. Klein and her son so long would have been more apt to awaken suspicion of her knowledge of the embarrassed condition of their affairs than would a continuance of such trust and confidence. It is not probable that she ever examined or scrutinized the accounts of the bank as to her rents or other collections, but left the keeping of them entirely to the employees and accepted them without question. We can see nothing in her course of trust in her son and her confiding her business transactions to his care that can raise the presumption of bad faith."

[19] *Weir* v. *Bell*, 3 Ex. Div. 243.
[20] 53 Fed. 436.

§ 138. Illustration — Lyon v. Council Bluffs Bank.

The case of *Lyon* v. *Council Bluffs Savings Bank*[21] is remarkable for the very clear opinion of Shiras, J., in which this point is brought well to the fore. There a merchant made a mortgage of all of his stock to the defendant bank. This mortgage was withheld from the record, because of the fear that it would hurt the plaintiff's credit. The defense argued that a series of decisions of the Iowa State courts, beginning with *Hughes* v. *Cory*[22] and ending with *Meyer* v. *Evans*[23] established the rule that the retention of possession by a mortgagor under an unrecorded mortgage does not render the instrument fraudulent in law, and that, consequently, the Federal courts were bound to follow this rule, as the mortgaged property was located in Iowa. The learned judge, however, answered this argument by showing that it assumed that when the State court decided that such a mortgage was not invalid as matter of law, therefore, it was valid as matter of law. This was not so. What the State courts really held was that the question was one of fact, to be decided in each case. The court then discussed a number of Federal decisions[24] and from them concluded that the mere withholding of a mortgage from record and allowing the mortgagor to remain in possession, with the right to sell the property in the usual course of trade, is proper under the Iowa statute, provided it is not done as a means of defrauding existing creditors. Whether or not sub-

[21] 29 Fed. 566.

[22] 20 Iowa, 399.

[23] 66 Iowa, 179.

[24] *Cragin* v. *Carmichael,* 2 Dill. 519; *Crooks* v. *Stewart,* 7 Fed. 800; *Argall* v. *Seymour,* 4 McC. 35; 48 Fed. 548; *Simon* v. *Oppenheimer,* 20 Fed. 553; *Rumsey* v. *Towne,* 20 Fed. 558; *Wells* v. *Langbein,* 20 Fed. 183; *Maish* v. *Bird,* 22 Fed. 576.

sequent creditors are defrauded, the learned judge concludes, brings into operation the doctrine of estoppel which involves " The application of a familiar principle not dependent upon the Iowa statute." There would seem no doubt as to the correctness of this proposition. Whether it does or should prevail nowadays is a question we have discussed in connection with the profession of the Federal courts to follow the State law in all such cases, if that law they can find.[25]

[25] *Supra*, § 18 et seq.

CHAPTER XIII.

FLOATING CHARGES IN MORTGAGES.

§ 139. Application of doctrine.

In the last chapter we dealt with the doctrine of reputed ownership as affecting mortgages by virtue of their recording, or the contrary. The same doctrine, however, has been applied to a numerous class of cases concerning the provisions of mortgages which, though the instrument be properly recorded, have none the less been set aside as against the mortgagor's creditors.

§ 140. "Sporting with the property."

As we have seen, a chattel mortgage or conditional sale was valid even under the Reputed Ownership Statute, provided that the continued possession by the debtor of the bargained property was consistent with the terms of the agreement between himself and the mortgagor or vendor. If the agreement also provides that the debtor can, if he pleases, consume or dispose of the identical property described in the agreement, or, to use the graphic term frequently employed in such cases, "sport with the property,"[1] then a different question is presented. Instances of such provisions in security agreements as time went on became very common.

§ 141. Validity of the equitable lien.

It is, of course, true that a court of equity will enforce an agreement to give a mortgage or lien, although that agreement is technically defective by

[1] *Brett* v. *Carter*, 2 Low. 458, Fed. Case No. 1844.

reason of error in description of the property, compliance with the statutory requirements, or the like.[2] This, being an equity, is enforceable by the party holding its benefits as against all privies of the debtor except purchasers of the property without notice. Hence it is enforceable against the creditors of the debtor, as the latter do not occupy the status of purchasers.[3]

§ 142. Holroyd v. Marshall.

It was on this basis that the House of Lords determined that what is commonly known as the after-acquired property clause of a mortgage was enforceable as against the creditors of the mortgagor.[4] This important feature is of universal presence in the modern industrial and railroad mortgages. In its usual form it provides that all machinery, implements and other acquisitions to the mortgaged property at any time placed thereon during the term of the mortgage, in addition to or substitution for anything on the premises at the date of the mortgage, shall be subject to the lien of the instrument. In *Holroyd* v. *Marshall*[5] it was held that such a provision was valid as against a creditor of the mortgagor who levied upon property forming such an acquisition.

[2] *Sprague* v. *Cochran,* 144 N. Y. 104; *Holroyd* v. *Marshall,* 10 H. L. C. 191.

[3] *Holroyd* v. *Marshall,* 10 H. L. C. 191; *Sprague* v. *Cochran,* 144 N. Y. 104; *Burdick* v. *Johnson,* 7 Hun, 488; *Nicholson* v. *Schumaker,* 81 Md. 459; *Mitchell* v. *Winslow,* 2 Story, 630, Fed. Cas. No. 9,673; *Crosswell* v. *Allis,* 25 Conn. 301; *Williams* v. *Clarke,* 47 Minn. 53; *In re International Mahogany Co.,* 147 Fed. 147, 16 Am. B. R. 797.

[4] *Holroyd* v. *Marshall,* 10 H. L. C. 191.

[5] 10 H. L. C. 191.

§ 143. **The logic of the equitable lien.**

It is quite obvious that a common-law court cannot, in any event, enforce such a clause, because all that would be before the court would be a mere agreement to give a lien requiring its specific enforcement as a preliminary to the affording of proper relief to the mortgagee. Consequently, as was settled at a very early date,[6] a common-law court is not the proper forum for the mortgagee to invoke.[7] On the other hand, a court of equity logically should enforce this provision as against the creditors of the mortgagor, because they are not innocent purchasers for value of the property, and it is only persons occupying such a status who can cut off what has been determined to be a plain equity.[8]

§ 144. **Its recognition with us.**

Such is the logic of *Holroyd* v. *Marshall, supra,* which is very hard to meet. It is not surprising, therefore, that at first it received the hearty approval of the New York courts.[9] The doctrine in truth did not find origin with the House of Lords. Many years before Mr. Justice Story, sitting on Circuit, had arrived at the same result.[10] The learned justice said:

> "It seems to me a clear result of all the authorities that wherever the parties by their contract intended to create a positive lien or charge either upon real or upon personal property,

[6] *Grantham* v. *Hawley,* Hobart, 132.

[7] *Rochester Distilling Co.* v. *Rasey,* 142 N. Y. 570; *Looker* v. *Peckwell,* 38 N. J. Law, 253.

[8] *Kribbs* v. *Alford,* 120 N. Y. 519; *Smithurst* v. *Edmunds,* 14 N. J. Eq. 408.

[9] *McCaffrey* v. *Woodin,* 65 N. Y. 459, 465.

[10] *Mitchell* v. *Winslow,* 2 Story, 630, Fed. Cas. No. 9,673.

whether then owned by the assignor or contractor, or not; or if personal property whether it is then *in esse* or not, it attaches in equity as a lien or charge upon the particular property as soon as the assignor or contractor acquires a title thereto against the latter, and all persons asserting a claim thereto under him, either voluntarily or with notice or in bankruptcy."

§ 145. **Lord Westbury's exposition.**

Lord Westbury in *Holroyd* v. *Marshall*,[11] put the proposition in accurate form in the following words:

"A contract for a valuable consideration by which it is agreed to make a present transfer of property passes at once the beneficial interest, provided the contract is one of which a court of equity will decree a specific performance. In the language of Lord Hardwicke the vendor becomes a trustee for the vendee; subject, of course, to the contract being one to be specifically performed. And this is true not only of contracts relating to real estate, but also of contracts relating to personal property, provided that the latter are such as a court of equity would direct to be specifically performed. A contract for the sale of goods, as for example, 500 chests of tea, is not a contract which would be specifically performed, because it does not relate to any chests of tea under contract; but a contract to sell 500 chests of the particular kind of tea which is now in my warehouse in Gloucester, is a contract relating to specific property, and which would be specifically performed."

[11] 10 H. L. C. 191.

It follows, of course, that a contract by which the mortgagor agrees to give a mortgage upon property to be placed upon a particular spot is a contract which comes within Lord Westbury's definition, and of which the mortgagee could ask specific performance.

§ 146. Modification of the rule necessary.

Of recent years, however, in this country, considerations, perhaps not of strict logic, but certainly of common sense, have led to a restriction of the doctrine, despite that its origin can be traced to such a high source as the authority of Lord Westbury and Mr. Justice Story. When it came to enforcing the after-acquired property clause of a mortgage, which after all really looked toward putting the debtor during the existence of the lien in the position of an owner of all the intangible and perishable assets of the mortgaged plant, leaving the provision merely that all property bought by him to replace property consumed or sold should become subject to the lien of the mortgage until it in turn was consumed or sold, logic in vain beckoned from the *via media* which the customs of our country prescribed. This question has been so fully discussed in the New York courts that a review of their decisions will clearly indicate what is believed to be the tendency of our courts.

§ 147. Present state of the law in New York.

Then began a series of restrictive decisions in the courts of New York, which finally ended in the present state of the law being practically this:

(1) An equitable lien exists which is enforceable against the creditors of the mortgagor, even in the event of the latter's insolvency, where a genuine

attempt was made to create a proper mortgage, but failed by reason of noncompliance with some technical rule of law.[12]

(2) The after-acquired property clause will be enforced if uncoupled with any other provisions of the mortgage allowing the mortgagee in turn to dispose of that property, the proceeds of such disposition in like manner to become subject to the mortgage.[13]

(3) But if the after-acquired property clause is tempered by other clauses allowing the mortgagor to handle and dispose of the floating property as his own, leaving the lien of the mortgage like a cloud to overhang all property while it is in his hands, then the whole agreement in this respect is void as against the mortgagor's creditors.

§ 148. **The later cases.**

The view of the highest court of New York on this third point was long in doubt, although the lower courts seemed to have little difficulty in holding this clause void as against the mortgagor's creditors, despite the favorable reception which the doctrine of *Holroyd* v. *Marshall* had first met.[14]

Finally, however, the point received very careful handling. In *N. Y. Security, etc., Co.* v. *Saratoga Gas Co.*,[15] the question was whether earnings of the

[12] *Black* v. *Ellis*, 197 N. Y. 402; *Hamilton Trust Co.* v. *Clemes*, 163 N. Y. 423; *Burdick* v. *Johnson*, 7 Hun, 488; *Sprague* v. *Cochran*, 144 N. Y. 104.

[13] *Kribbs* v. *Alford*, 120 N. Y. 519; *National Bank of Deposit* v. *Rogers*, 166 N. Y. 380; *McNealey* v. *Welz*, 166 N. Y. 124; *Central Trust Co.* v. *West India Imp. Co.*, 169 N. Y. 314.

[14] *Farmers' Loan & Trust Co.* v. *Long Beach, etc., Co.*, 27 Hun, 89; *Platt* v. *N. Y., etc., Ry. Co.*, 17 Misc. 22.

[15] 159 N. Y. 137.

mortgagor, derived between the date of execution of the mortgage and the date of foreclosure, on hand in the shape of cash in bank and the like, should be paid to the trustee under the mortgage, or to the receiver appointed in sequestration proceedings instituted by creditors of the mortgagor. It was held that to the latter party belongs this fund. The reason assigned by the court for this view is that to reach an opposite result "would deprive the unsecured creditor of the fund, upon the faith of which he may have given credit to the mortgagor during the time when the latter was permitted to deal with and use it as his own." This, of course, is an exact statement of the doctrine of reputed ownership. In *Zartman* v. *Bank of Waterloo*,[16] the rule of the *Saratoga Gas. Co. Case* was given its logical extension to the case of tangible personal property of the mortgagor, as well as the earnings derived by it from the conduct of the plant covered by the mortgage. The court observes that the question arose "between the mortgagee and the general unsecured creditors, who had little, if anything, to rely upon, except the shifting stock, which, directly or indirectly, they themselves had furnished."

§ 149. Their basis the doctrine of reputed ownership.

Thus, upon a most important subject from the viewpoint of modern business and financial customs, we find the same principle of reputed ownership given full vigor by the New York courts. An interesting feature of such a case is the position which a court of equity is called upon to take in the transaction. In most of the cases bearing on this subject of reputed

[16] 189 N. Y. 267.

ownership the chancery court is asked to take affirmative action in behalf of the deluded creditors and to enjoin the true owner of the property from enforcing his legal title. In this case, on the other hand, the court is asked by the creditors merely to withhold its hand. The legal title to the property being in the mortgagor, and the mortgagee having merely an equity, if any, the court is asked to refuse the enforcement of this equity, because the nature of the original transaction out of which this equity arose gave birth to a representation to the mortgagor's creditors which the mortgagee should be estopped to deny. The curious may compare this situation with the ancient case of *Edge* v. *Worthington*,[17] where Kenyon, M. R., decided that an equitable mortgage created by a deposit of title deeds is superior to the claims of creditors of the mortgagor, who asserted they had been deluded by the latter's remaining in ostensible ownership of the property. There is, however, this difference between *Edge* v. *Worthington* and the modern case of the class described. In the English case the transaction was honest in its inception, and there was no intention that the creditors of the mortgagor should later be deceived. In the mortgage cases, of which we have spoken, on the contrary, the parties to the transaction as it was originally made intended that the mortgagor should gain credit on the strength of his use of the floating property, because as both Vann, J., in *Zartman* v. *Bank of Waterloo* and O'Brien J., in *New York Security, etc., Co.* v. *Saratoga Gas Co.*,[18] pertinently observe, the mortgagor did not have, and in all human probability never would have had, anything else on which to ask for credit.

[17] 1 Cox Ch. C. 211.
[18] *Supra.*

§ 150. **This basis not one of strict reason.**

Of course, as was pointed out by Lord Chelmsford in *Holroyd* v. *Marshall*,[19] public notice was given in the case of the mortgage there under consideration, by its registration under the English Bill of Sales Act. In like manner public notice of the contents of every industrial mortgage ever put in force in this country is given through similar instrumentalities afforded by the various States. It must be confessed that it is a little inconsistent for the courts to say that the provisions of a mortgage, such as were condemned in the cases above discussed, can result in harm to the creditors of the mortgagor when public notice is afforded them by the registration of the instrument. But as a practical matter it may be affirmed that trade creditors of an industrial concern do not examine the latter's mortgages, however the same may be of public record. Certainly, it is true, as Vann, J., observed in *Zartman* v. *Bank of Waterloo*,[20] that "if it is understood that a corporate mortgage given by a manufacturing corporation may take everything except accounts and debts, such corporations, with a mortgage outstanding, will have to do business on a cash basis, or cease to do business altogether." It is, therefore, a sort of mixture of common-sense knowledge of the course of trade and ideas of public policy that led the courts to apply the doctrine of reputed ownership to this class of cases.

§ 151. **No direct Federal decisions.**

The question has not been squarely presented as yet to the Federal courts. As we have seen, their rule is

[19] *Supra.*

[20] 189 N. Y. at p. 272.

that all questions of this kind are to be determined according to the law of the State where the property is located. Thus the New York rule, of which we have been speaking, was applied according to its letter by the Circuit Court of Appeals, Second Circuit, in *In re Marine Dry Dock, etc., Co.*[21] The United States courts have gone very far toward enforcing the after-acquired property clause in the case of railway mortgages,[22] but whether, as has been suggested by Mr. Justice Gaynor,[23] the case of a railroad mortgage constitutes an exception, or should do so, is still an open question.

§ 152. The English rule to the contrary.

The English courts, on the contrary, have always upheld, as against the mortgagor's creditors, the floating charge created by the conjunction of the after-acquired property clause with others of the class mentioned. In the case of such a mortgage executed by a trader, the courts consider that sufficient rebuttal of presumptive ownership is afforded by the registration of the mortgage under the Bill of Sales Act.[24]

§ 153. The Companies Acts exclude reputed ownership.

In the more common case of a corporate mortgage of this class, the English courts consider the matter

[21] 144 Fed. 649, 16 Am. B. R. 325.

[22] *Dunham* v. *Cinn., etc., Ry. Co.*, 1 Wall. 254; *Porter* v. *Pittsburg Steel Co.*, 122 U. S. 283, 7 Sup. Ct. Rep. 1206; *Fogg* v. *Blair*, 133 U. S. 534, 10 Sup. Ct. Rep. 338; *Toledo, etc., Ry. Co.* v. *Hamilton*, 134 U. S. 296, 10 Sup. Ct. Rep. 546; *Central Trust Co.* v. *Kneeland*, 138 U. S. 419, 11 Sup. Ct. Rep. 357.

[23] *Platt* v. *N. Y., etc., Ry.*, 17 Misc. 22.

[24] *Holroyd* v. *Marshall*, 10 H. L. C. 191; *Ashton* v. *Blackshaw*, L. R., 9 Eq. 510; *Crawcour* v. *Salter*, 18 Ch. D. 30, 42–48.

at an end by reason of the failure of Parliament to extend the reputed ownership clause to the winding up of companies.[25] Consequently, the floating charge created by a corporate mortgage is always entitled to enforcement on the theory that it is an equitable lien which is valid as against all save innocent purchasers for value.[26] Up to 1900 the Companies Acts in force always provided that mortgages or deeds securing debentures should be registered, but contained nothing which would make an unregistered mortgage void as against the creditors or liquidator. It was finally held[27] that there was no ground for holding the mortgage void, and that the provision was directory merely in the case of a simple creditor. As the court said, undoubtedly the mortgagee would be guilty of fraud which would render him personally actionable, but the mortgage would not be void.[28]

§ 154. **Enforcement of floating charge in England.**

The only question that ever was seriously pressed, in this connection, before the English courts, was whether the floating charge could be enforced as to income which had accrued before the mortgagee had taken steps to enforce his lien This was decided negatively by the House of Lords,[29] but obviously this decision, though cited as authority therefor, does not support the view of the New York courts, that a float-

[25] *In re Crumlin Viaduct Co.,* 11 Ch. D. 755; *Gorringe* v. *Irwell Rubber Co.,* 34 Ch. D. 128.

[26] *In re Colonial Trusts Corporation,* 15 Ch. D. 465; *In re Florence Land Co.,* 10 Ch. D. 530; *Tailby* v. *Official Receiver,* 13 A. C. 523.

[27] *Wright* v. *Horton,* L. R., 12 A. C. 371.

[28] *In re Globe Iron Co.,* 48 L. J. Ch. 295; *Wright* v. *Horton,* 12 A. C. 371.

[29] *Government, etc., Co.* v. *Manila, etc., Co.* (1897), A. C. 81.

ing charge is enforceable neither before, nor after, the proper steps are taken for its enforcement. It is noteworthy, however, that under the Companies Acts of 1900 (§ 14)[30] and 1908 (§ 93)[31] all corporate mortgages, if not registered, are void as against the company's creditors or liquidator; and that, accordingly, a general floating charge to secure debentures, a hitherto favorite English method, falls within this new statutory requirement.[32] Within these limits, however, the floating charge is still entitled to enforcement *a outrance*.[33] Of course, now that the English statute requires the registration of every floating charge, creditors are, under the English theory already mentioned, put on notice in advance, and can claim no estoppel.[34] But it is difficult to justify those earlier English cases where a secret floating charge was allowed as against the company's creditors. It is deferentially suggested that, had the idea of estoppel been vigorously pressed upon the courts, perhaps a different result might have been attained.

§ 155. The basis of the New York rule is well settled in American jurisdictions.

The view of the New York courts that the after-acquired property clause of the modern mortgage is of practically no effect as against the subsequent creditors of the mortgagor finds support in decisions that were made at a much earlier date in this country, and which doubtless would have no favor in England.

[30] 63, 64 Viet. C. 48.

[31] 8 Edw. VII. C. 69.

[32] *Illingsworth* v. *Hovldsworth* (1904), A. C. 355.

[33] *Norton* v. *Yates* (1906), K. B. 112; *Cox* v. *Peruvian Ltd.* (1908), 1 Ch. 604.

[34] *Holroyd* v. *Marshall*, 10 H. L. C. 191.

These decisions are numerous in the various States. But the leading case is *Robinson* v. *Elliott*.[35] In that case the rule was laid down that a mortgage which permits the mortgagor, in addition to retaining possession of the mortgaged property, to sell and dispose of the same as though it were his own, and with the proceeds to acquire new property which in turn he may use in the like manner, is invalid as against his creditors, despite the fact that it was duly recorded under the local statutes. The court in that case was not following the local law, but on the contrary prefaces its ruling with the statement "as the question has never before been presented to this court we are at liberty to adopt that rule on the subject which seems to us the safest and wisest."[36]

The essence of the decision is contained in the following extract from the opinion delivered by Mr. Justice Davis:

> "Manifestly it was intended to enable the mortgagors to continue their business and appear to the world as the absolute owners of the goods and enjoy all the advantages resulting therefrom. It is idle to say that a resort to the record would have shown the existence of the mortgage, for men get credit by what they apparently own and possess, and this ownership and possession had existed without interruption for ten years. There was nothing to put creditors on their guard. On the contrary continued possession and apparent ownership were well calculated to create confidence and disarm suspicion."[37]

[35] 22 Wall. 513.
[36] 22 Wall. 523.
[37] 22 Wall. 525.

§ 156. A loose mortgage the same as an unrecorded mortgage.

This decision puts upon the same plane with a mortgage withheld from record in order to deceive the creditors of the mortgagor, an instrument which though duly recorded permits the mortgagor to deal with the property as though it were his own. It represents what may fitly be styled the general American rule. Clear expression of this doctrine is given by Ray, J., in a recent case:[38]

> "The distinction is sharply drawn between that line of cases where the title to property sold is to pass when paid for only, and in the meantime the property is to be retained and used by the vendee, or if sold, the proceeds are to take or stand in its place and be passed over to the vendor in payment or as his own, and that other line of cases where the sale is in terms conditional —that is, it is provided that the title shall remain in the vendor until the property is paid for, but, still, the vendee is given full power to use up, consume, or sell and give good title and take or hold the proceeds as his own. * * * If the vendor parts with the possession to the vendee and invests him with the right to sell as his own and treat the proceeds as his own, then the sale is absolute, and the title is in the vendee absolutely, as fraud is presumed even if there be an agreement that title to the property shall remain in the vendor until the debt is paid. But if the agreement be that the vendee may sell, and that if he does he shall pay over the proceeds to the vendor

[38] *Pontiac Buggy Co.* v. *Skinner*, 158 Fed. 858, 20 Am. B. R. 206.

> to apply on the debt, then there is no fraud, and the vendor has the title. If a mortgage permits the mortgagor to sell and use the proceeds as his own the transaction is presumed fraudulent, and the mortgage is void. If the mortgage permits the mortgagor to sell and stipulates that the proceeds shall apply on the mortgage debt the mortgage is valid. The normal and proper purpose in both cases is that the proceeds shall be applied in extinguishment of the debt."

In other words, the recording acts, though useful, yet have their limitations and cannot hide the fact which existed long before they were framed, that, as expressed by Mr. Justice Davis,[39] "men get credit for what they apparently own and possess." As stated by Sir Edward Coke in *Twyne's Case*,[40] "possession (in such a case) is a sure badge of fraud." It is, therefore, submitted that Severens, J., erred when in a later case[41] he held that such a mortgage was void as against creditors existing at the time of its execution, but was not void as to subsequent creditors. The learned judge apparently kept one eye firmly fixed on the doctrine of fraudulent conveyances but closed the other as to all the law of reputed ownership. The mortgage there provided that until default the mortgagor should retain the property and the income and have the same power to control and sell the same as if the mortgage had not been made. A clearer case, it is believed, could not have existed, yet we find the learned judge saying: "In the case of a concealed fraud one subsequently becoming a creditor might be exposed to the like injury; but where that of which he

[39] *Robinson* v. *Elliott*, 22 Wall. 523.

[40] 3 Coke's Rep. 80b.

[41] *Central Trust Co.* v. *East Tenn. Land Co.*, 71 Fed. 353.

might otherwise complain is open and before his face he accepts the situation and should abide the consequences. He has nothing to complain of." That is quite true under the English rule which gives recording acts their fullest effect along with the doctrine of equitable lien, as expounded in *Holroyd* v. *Marshall*.[42] But it is not true under all the current of American authority, and it certainly is contrary to the decision of a higher court in *Robinson* v. *Elliott*,[43] followed in *Russell* v. *Wynne*.[44]

§ 157. The Federal rule as to the earnings of the mortgaged property.

More closely allied to the rule laid down by the House of Lords in *Government, etc., Co.* v. *Manila, etc., Co.*,[45] is the doctrine of a series of decisions by the United States Supreme Court.[46]

In the English cases, as we have seen, it was held that a floating charge could not be enforced as to income which had accrued before the mortgagee took possession of the property, either by entry or the appointment of a receiver. The Supreme Court in the cases cited has established the rule that although a mortgage may provide that the earnings of the mort-

[42] *Supra.*

[43] *Supra.*

[44] 37 N. Y. 591.

[45] 1897, A. C. 81.

[46] *Galveston R. R.* v. *Cowdry*, 11 Wall. 459; *Gilman* v. *Ill. Tel. Co.*, 91 U. S. 603; *Am. Bridge Co.* v. *Heidelbach*, 94 U. S. 798; *Sage* v. *Memphis, etc., Ry. Co.*, 125 U. S. 361, 8 Sup. Ct. Rep. 887; *Dow* v. *Memphis, etc., Ry.*, 124 U. S. 652, 8 Sup. Ct. Rep. 673; *Teal* v. *Walker*, 111 U. S. 242, 4 Sup. Ct. Rep. 420; *U. S. Trust Co.* v. *Wabash, etc., R. R. Co.*, 150 U. S. 287, 14 Sup. Ct. Rep. 86; *Freedmen's Savings Co.* v. *Shepherd*, 127 U. S. 494, 8 Sup. Ct. Rep. 1250.

gagor and the rents of the property shall be subject to the mortgage, yet this provision has no effect until the entry of the mortgagee either personally or by means of a receivership.

§ 158. Its reason.

It must be confessed that the reasons given by the Supreme Court for this rule are not very satisfactory. In *Galveston R. R.* v. *Cowdry*[47] the rule was founded upon the case of *Chinnery* v. *Black*,[48] where it was first announced that rent of mortgaged property cannot be considered as being within the lien of the mortgage where the mortgagee is not in possession. Of course that is true, but *Chinnery* v. *Black* was an action at law and nothing was there said as to the effect of a special provision assigning the income in advance to the mortgagee. Nevertheless the Supreme Court, having once stated the rule, followed it consistently, and it is now the established doctrine of the Federal forums.

[47] *Supra.*
[48] 3 Doug. 391.

CHAPTER XIV.

CONSIGNMENT ARRANGEMENTS.

§ 159. Good faith the test.

Once more to repeat,—no arrangement otherwise sanctioned by the law can be attacked under the doctrine of reputed ownership unless the bad faith of the transaction is apparent. A bailment of goods is valid and always was, even in the strictest days of the Reputed Ownership Statutes. Even in the case of a factor who, perhaps, might hold the goods under a *del credere* arrangement, the transaction was upheld because, to use the words of the English Judges, it was made with an honest intent.[1] This would seem to have been settled beyond controversy by the foundation case of *Mace* v. *Cadell*[2] but only recently the Federal Courts of Appeals of the Sixth and Seventh Circuits have been called upon to determine the point all over again.[3] Certainly we may regard it as now settled.

§ 160. Sale or return arrangements.

Thus the so-called sale or return arrangement which as between the parties has frequently been defined[4] has been upheld as against a trustee in bankruptcy.[5] These memorandum transactions, as Hough,

[1] *Mace* v. *Cadell,* 3 P. Wms. 186, Cowp. 233.

[2] Cowp. 232.

[3] *In re Taft,* 133 Fed. 511, 13 Am. B. R. 417; *In re Galt,* 120 Fed. 64, 13 Am. B. R. 575.

[4] *Hunt* v. *Wyman,* 100 Mass. 198; *Sturm* v. *Boker,* 150 U. S. 312, 14 Sup. Ct. Rep. 99; *Guss* v. *Nelson,* 200 U. S. 302, 26 Sup. Ct. Rep. 260; *Carter* v. *Wallace,* 35 Hun. 189.

[5] *In re Schindler,* 158 Fed. 458, 19 Am. B. R. 800; *Ex parte Wingfield,* 10 Ch. Div. 591.

J., says,[6] "now so common in mercantile circles" were made with an honest intent, "chiefly, if not wholly, because his (the bankrupt's) term of credit would run from the thirty day period rather than the day of delivery." "This desire of his," as Hough, J., rightly says, "does not in my opinion change the legal results."[7] In the English case cited[8] James, L. J., disposes of the matter by the statement that the reputed ownership clause must be read "with some attention to common sense."

§ 161. The doctrine does not touch innocent transactions.

With such innocent transactions the doctrine of reputed ownership has nothing to do. We deal here with those cases of quite another color, where the attempt is made to cloak with the due form of law arrangements whose real object is to give to the bailee the character of an owner and reserve to the bailor an owner's rights in the event of the bailee's insolvency. Transactions such as these have become very common in this country in the last fifty years. The necessities of business and of finding a market for their output have made many large manufacturers endeavor to keep up a person whose credit is not above reproach, in order that an outlet for their products may thus be supplied. The contracts drawn in such cases have taken many forms and discussion of the rule which has been gathered from the decisions on this head must of necessity concern itself largely with the facts of each case.

[6] *In re Schindler,* 158 Fed. 458, 19 Am. B. R. 800.
[7] *In re Schindler,* 158 Fed. 458; 19 Am. B. R. 800.
[8] *Ex parte Wingfield,* L. R. 10 Ch. Div. 591.

§ 162. The unlawful use of the bailment idea is condemned.

But the rule when once adduced is easy of statement. It is simply that any transaction which goes beyond the narrow path of the legitimate use of the bailment contract, is condemned by the law. As we have seen, conditional sale agreements were valid at common law, although the vendee was in possession of the property at the time of his insolvency, if the original agreement provided that he should have such possession.[9] A conditional sale, reduced to its last analysis, is nothing but a bailment pure and simple. It is simply an agreement that the vendee will on or before a certain date purchase specified goods from the vendor, and in the meantime may have the possession of them. If the King's Bench had refused to recognize the validity of such an agreement it would at one stroke have destroyed the entire law of bailment, because the essence of a conditional sale agreement is a commonplace bailment. Therefore, as a bailment agreement it is valid under the doctrine of reputed ownership, and all courts rightly understanding that doctrine have so held.[10] It is likewise with the so-called consignment account. That is nothing but a bailment. The only difference between it and a conditional sale is that in a consignment the goods are entrusted to a factor with power to sell the same to other persons. The duty is, therefore, on the factor to account in full for each sale to his principal. If the factor also has the right, should he so please, to purchase the goods himself from his principal, the agreement then made would simply be a combination

[9] *Martindale* v. *Booth*, 3 B. & Ad. 498; *Harkness* v. *Russell*, 118 U. S. 663, 7 Sup. Ct. Rep. 51.

[10] See *Harkness* v. *Russell*, 118 U. S. 663, 7 Sup. Ct. Rep. 51.

of a consignment and conditional sale agreement, and likewise would be valid.

§ 163. Ordinary conception of a consignment.

The proper conception of a conditional sale is pictured by the common instance of a piano sold on the installment plan. If the vendor suspected that the purchaser contemplated selling the piano to somebody else before the last installment was paid, he would lose no time in removing it. And so with fixtures supplied to a factory on the installment basis.[11] The ordinary case of a consignment is where a farmer sends produce to a city commission merchant for sale. He expects a full accounting of each sale and if he did not receive it would speedily consult his lawyer. Such transactions are not within the ban of the law, because they are made with an honest intent. It is only when the effort is made to spread their guise of innocence over a transaction of a wholly dissimilar character that the law of reputed ownership can be invoked.

§ 164. Its unlawful extension.

When a conditional sale agreement allows a vendee to deal with the goods as his own, to sell them to whom he pleases, and the consignor requires his consignee to make no accounting, nor, indeed, any reparation beyond the payment of a fixed scale of prices at fixed periods, then the transaction assumes quite a different shape. A very graphic statement of the chasm which yawns between cases such as these and the innocent ones as described is furnished by Archbald, J., in *In re Wells*,[12] "There is no particular

[11] *In re Cohen*, 163 Fed. 444, 20 Am. B R. 796.

[12] 140 Fed. 752, 15 Am. B. R. 419.

magic in the terms 'consigned' and 'consigned account.' In a sense all goods shipped to another are consigned to him. The question is — what was the inherent nature of the transaction which depends upon the purpose of it?"

In the recent case of *In re Penny and Anderson*[13] Referee Dexter, whose ruling was approved by Hough, J., expresses the same idea:

> "The vice in the latter transaction lies in the fact that the goods were delivered for consumption or sale in a way inconsistent with continued ownership of the vendor, and, therefore, constituted a fraud upon the vendor's creditors * * * The transaction in question did not constitute the relations of principal and factor, for a factor cannot make a profit by his agency nor a valid purchase for himself and receive a commission for his services."

§ 165. In re Garcewich.

A leading case on this subject is *In re Garcewich*.[14] In that case a so-called conditional sale agreement was made, which provided that the vendee could sell and dispose of a line of wearing apparel at such prices as he might desire, paying to the vendor at stated intervals fixed prices which were provided by the vendor at the time of each delivery of goods. This agreement was properly filed as a conditional sale contract under the provisions of the New York law. The referee and the Federal district judge held that the agreement after all was a conditional sale agreement, because, as between the parties, it was

[13] 176 Fed. 141, 23 Am. B. R. 115.
[14] 115 Fed. 87, 8 Am. B. R. 149.

distinctly provided that title to the property should not pass until either the goods had been sold to third persons by the vendee or remittances made by him to the vendor, and as the instrument had been properly filed the creditors could not complain, because they had record notice. But the Circuit Court of Appeals, Second Circuit, reversed this determination, saying, per Wallace, J., that "when the purpose for which the possession of property is delivered is inconsistent with the continued ownership of the vendor the transaction will be presumed fraudulent as against purchasers and creditors. The transaction will be deemed merely colorable and the title to have been vested absolutely in the buyer." And pursuing this trend of thought, the court said that "such an arrangement if expressed defeats its essential nature and qualities so that in a legal sense it is not a security but merely the expression of a confidence."

§ 166. Incorrectness of language used.

It is submitted that this language while true in its ultimate sense is incorrect in the view that the transaction was colorable and the title vested absolutely in the buyer. That could not be unless it was actually a sale as between the parties. If as between the parties the transaction was not a sale it could only be set aside as to the creditors on the basis of an estoppel.

§ 167. Treating the arrangement as a sale in fact — Ex parte White.

There is considerable ground for the view that a transaction of this sort in fact constitutes a sale.

Such was the opinion of the English courts in a somewhat similar transaction.[15]

The firm of Towle & Co. had the custom of sending cotton yarn to the bankrupt upon the terms that the bankrupt could make it up into goods and sell the same to whatever customers and on whatever credit he chose. A list of prices accompanied the goods so sent and at the end of each month the bankrupt rendered an account of the yarn sold and the following month paid Towle & Co. for the quantity sold according to the price list. The question here came up on the attempt by Towle & Co. to trace moneys in the hands of the bankrupt as specific trust money held for them by their agents. The court held against them and the House of Lords affirmed the judgment. The reasoning of the court is thus expressed by Mellish, L. J.:

> "If the consignee is at liberty according to the contract between him and his consignor to sell at any price he likes and receive payment at any time he likes, but is to be bound, if he sells the goods, to pay the consignor for them at a fixed price and a fixed time, in my opinion, whatever the parties may think, their relation is not that of principal and agent. The contract of sale which the alleged agent makes with his purchasers is not a contract made on account of his principal, for he is to pay a price which may be different, and at a time which may be different from that fixed by the contract."

Lord Selborne, L. C., who delivered the judgment of the House of Lords, said that "it is not a question of law, but simply of fact." The Lord Chancellor then proceeded:

[15] *Ex parte White,* L. R., 6 Ch. App. 397, affd. under name of *Towle* v. *White,* 21 W. Rep. 465.

> "Now, with regard to the point which does require some consideration — that for a certain period those goods were Towle's. Suppose I have trust and confidence in a man who has business relations with me, and I send to him as consignee or otherwise goods in order that they may be brought to market, and that the understanding between us is 'when you are able to find a market for these goods you may sell them on your own account, accounting to me for a certain price which I have fixed upon them.'"

The Lord Chancellor approved the language of Mellish, L. J., above quoted, saying:

> "The course of dealing speaks for itself. In my opinion, the course of dealing is that which the Lord Justice Mellish describes it to be."

He then quoted the language of Mellish, L. J., and proceeded:

> "Several tests were put in the course of the argument to the appellants' counsel, and they accepted those tests, though some of them with a greater sense of difficulty than others. Those tests might be thus stated: would or would not the purchaser be liable in every one of these cases to an action by Towle & Co. for the price which Nevill was to have paid Towle & Co. for the goods? Of course the whole argument assumed that the purchaser would be so liable, yet, if this were so, it follows that, if there were anything in the article delivered upon which an action against the vendor could be founded by the purchaser, then

every one of these customers could recover against Towle & Co. What could be conceived more contrary to the spirit of the contract between these parties? What would have more astonished Mr. Towle if the bleacher and the dyer of the goods had sued him for the cost of the bleaching and the dyeing? And this argument also requires that, if the moneys received from the purchaser of the goods had not been sufficient, Nevill himself might have had an action for the costs of bleaching and dyeing against Towle & Co. All I say is that I am convinced that any one of these consequences would have been as completely opposed to the understanding of the parties as it would have been to the legal effect of the contract."

§ 168. **The same — Ludvigh v. Woolen Company.**

In *Ludvigh* v. *American Woolen Co.*,[16] Hough, J., was influenced by this double point of view. That case first came up on demurrer to the bill of a trustee in bankruptcy. The object of the bill was to recover the value of woolens removed by the defendant from the bankrupt's place of business immediately prior to their failure.

On final hearing of *Ludvigh* v. *American Woolen Co.*[17] the facts showed an arrangement very similar to that in *Ex parte White.*[18] Hough, J., while holding that the transaction as against the consignee's creditors was one of sale and not bailment, postulated that *inter partes* the arrangement was as the parties made it. He declared that " it does not advance the matter

[16] 159 Fed. 796, 19 Am. B. R. 795.
[17] 176 Fed. 145, 23 Am. B. R. 314.
[18] *Supra.*

to point out that the arrangements complained of were valid and lawful *inter partes;* that is admitted, but so are most conveyances actively fraudulent as against creditors."

§ 169. **The final line of thought.**

The parties are free to stipulate as between themselves when and how the title to the goods may pass. With that aspect of the various consignment arrangements of modern framing we have nothing to do. But how, as against creditors, the courts will view the matter, depends on the presence or absence of certain well defined tests. It is well, however, to keep this point in mind when reading the decisions, that the touchstone applied by the courts in ascertaining whether a consignment arrangement constitutes a bailment or a sale, differs in intensity according as the contest arises between the parties to the arrangement or as between the consignor and the consignee's creditors. In the latter case the courts are always influenced by the idea that an arrangement whereby the strings on the property are to be pulled by the consignor only in the event of the bailee's insolvency, will not be permitted to stand against the consignee's creditors. " In my opinion," says Hough, J., in the case already mentioned[19] " the contracts in question plainly show an endeavour to obtain for the Woolen Company all the rights of both vendor and bailor, while denying to the Niagara Company the privileges of either a vendee or bailee. This cannot be done as against creditors, who are entitled to have the test of the law applied to the transaction, however valid as between the parties themselves."

[19] *Ludvigh* v. *Am. Woolen Co.,* 176 Fed. 145, 23 Am. B. R. 314.

§ 170. The reservation of title a real thing.

Such a reservation of title is a legal fact which no court can ignore. A law court cannot override it. Nor can a court of equity, save in the proper action, framed on the theory, not that the consignor did not reserve title — that would not be true — but that such reservation should not be permitted as against the just rights of the consignee's creditors.

§ 171. And cannot be ignored.

The case of *Walther* v. *Williams Merc. Co.*,[20] is in point. The trustee brought his action on a technical theory which did not find support by the facts. The court says:

> "The theory of the trustee on which he prosecutes his original case and now prosecutes error, is that the transaction between the Mercantile Company and Walker & Williams was a sale, and therefore, the turning back of the property in January, 1907, was the payment of a debt, and if so, a preference. The court below denied the validity of this claim. We are of the opinion that the District Court was right in holding that no sale was made * * *. Whether such a transaction could on behalf of the creditors in any other way than that resorted to here be avoided is not before us."[21]

As between the parties it might be questioned whether the transaction was technically a sale. The trustee in the *Walther* case dealt in metaphysics instead of bringing his action on the theory that the

[20] C. C. A., 6th Circ., 169 Fed. 270, 22 Am. B. R. 328.
[21] 169 Fed. 273.

transaction was a fraudulent one, and as against creditors would be considered either a sale or presumptively fraudulent, to use the language of the *Garcewich* case, as one might choose. The court refused to consider whether the transaction could have been avoided "in any other way than that resorted to."

§ 172. The distinction between sale and bailment — One test.

What, then, is this test of the law? One such test is found, among other places, in the leading case of *Sturm* v. *Boker*.[22] Boker delivered to Sturm a quantity of arms to be taken to Mexico and there sold by Sturm. The agreement provided that if the arms should be sold at a loss, Boker should bear the loss; if at a profit, the parties should divide the same. The gist of the matter lay in the additional provision of the agreement that all arms remaining unsold were to be returned to Boker. Sturm insured the goods for whom it might concern. A loss occurring under the policy, not caused by Sturm's negligence, Boker collected the insurance thereon. Sturm's suit for the insurance money collected by Boker was dismissed, the court holding that the transaction was one of bailment. Although the controversy arose between the parties themselves, yet the test there laid down by the Supreme Court is recognized, as the court intended it should be, as applicable to controversies between the consignor and the consignee's creditors. The court, indeed, says: "Suppose a creditor of Sturm had levied upon or seized these goods after they reached his possession; it cannot be doubted that the defendants (Boker & Company) could have

[22] 150 U. S. 312, 14 Sup. Ct. Rep. 99.

recovered them as their property." The test adopted there is whether the identical article to be delivered "is to be returned in the same or some altered form." If so, then you have a bailment. But "when there is no obligation to return the specific article, and the receiver is at liberty to return another thing of value, he becomes a debtor to make the return, and the title to the property is changed; the transaction is a sale."

§ 173. **The same — Other tests.**

The identity of the returned article is by no means a complete test, however. The agreement must be such that the bailee has no room for discretion in this respect. This the Supreme Court recognized in an earlier case.[23] There a patentee undertook to manufacture his patented articles for the account of the plaintiff, who was to advance to the patentee a stated sum monthly to cover his expenses of operation, and to supply him with all raw material necessary for the finished product, or with funds sufficient to purchase raw material elsewhere. A judgment creditor of the patentee levied on certain finished products, composed of raw material furnished by the plaintiff, which had not yet been delivered to the latter. The court held that a purchaser on the execution sale took a good title, saying:

> "We see nothing requiring that the identical acids sent should be used in the manufacture of the explosives, and nothing to prevent an exchange by Dittmar for other materials, if he found any of the articles to be unsuitable, or if he found that he had too much of one kind and too little of another, acting honestly in the inter-

[23] *Powder Co.* v. *Burkhardt*, 97 U. S. 110.

est of both parties. The case is quite different from the single mechanical transaction of turning a specific set of logs into boards or a specific lot of wheat into flour, where there is no room for judgment or discretion."

§ 174. **Tests as against creditors.**

In both of these cases the doctrine of reputed ownership, of course, had no play. Both actions were at law, and the question was whether, as between the parties, the transaction was really one of bailment or of sale. In several cases, however, belonging to the class where creditors' rights are actually involved, we find these same tests repeated, and others given as well. Thus in *In re Wells*,[24] Archbald, J., says:

"Were the goods put in the hands of the one party by the other, to be sold for him and on his account, creating the relation of principal and factor; or were they turned over to such party, to be treated and disposed of as his own, being responsible to the other simply for the price? In the one case we have a trust or bailment, the goods throughout being those of the consignor or principal, as well as the moneys received for them. In the other there is a sale; the superadded condition sometimes appearing that the title shall not pass until the goods are paid for, amounting to nothing as a restriction upon it. The cases of *McCullough* v. *Porter*,[25] and *Keystone Watch Co.* v. *Bank*,[26] are examples of the one class; and *Thompson* v. *Paret*,[27] *Peek* v.

[24] 140 Fed. 752, 15 Am. B. R. 419.
[25] 4 Watts & S. 177, 39 Am. Dec. 68.
[26] 194 Pa. St. 535, 45 Atl. 328.
[27] 94 Pa. St. 275.

Heim,[28] and *Braunn* v. *Keally*,[29] of the other; of which *Thompson* v. *Paret* and *Peek* v. *Heim* are particularly significant; the arrangement there being denominated a consignment, but this being held ineffectual to disguise the real character of the transaction. The subject is well disposed of in 24 *Am. & Eng. Encycl. Law*, (*2d Ed.*) 1026, where it is said: 'In case of goods consigned to be sold for the consignor, who is to regulate the price and terms of sale, the factor is an agent, and the contract one of bailment. And this is so, though the consignment is made on a *del credere* commission. If, however, the consignee or factor is to sell upon terms fixed by himself, and is bound to pay to the consignor a fixed price, the contract is one of sale.'"

And in *In re Penny & Anderson*,[30] the court says:

"The transaction in question did not constitute the relation of principal and agent, for a factor cannot make a profit by his agency, nor a valid purchase for himself, and receive a commission for his services."

And this again from *Sturm* v. *Boker*:[31]

"An essential incident to trust property is that the trustee or bailee can never make use of it for his own benefit."

The late case of *Ludvigh* v. *American Woolen Co.*[32]

[28] 127 Pa. St. 500, 17 Atl. 984, 14 Am. St. Rep. 865.
[29] 146 Pa. St. 519, 28 Am. St. Rep. 811, 23 Atl. 389.
[30] 176 Fed. 141, 23 Am. B. R. 115.
[31] 150 U. S. 312, 14 Sup. Ct. Rep. 99.
[32] 176 Fed. 145, 23 Am. B. R. 314.

contains a *resumé* of the more important and interesting of the decisions on this topic, and the conclusion of the learned judge, as there expressed, would really seem to be the last word on the law:

> "It has never been held that one to whom goods were delivered, which he not only might sell, but must pay for whether he sold them or not, and who also cannot return any of the merchandise, is a bailee, and if he be not a bailee he cannot be a consignee."

§ 175. Description by the parties not conclusive.

We must now turn to that difficult class of cases, so numerous in the Federal courts of a late date, where the courts are asked to set aside on the ground of estoppel, or to consider as sales, transactions labeled to the opposite effect by the parties themselves. Both *Sturm* v. *Boker*,[33] and *Powder Co.* v. *Burkhardt*,[34] were not of this class. The parties there did not label their agreements at all. The court construed them as between those parties, but creditors' rights were not involved. And although the rights of creditors were involved in *Ex parte White*,[35] yet the parties did not label their transaction, and the court defined it as it really was from its viewpoint. We now come to the cases where a specific reservation of title is made by the consignor, to be operative in the event of the consignee's insolvency.

§ 176. The Federal decisions.

Let it be remembered that the latter-day profession of the Federal courts is to follow the State

[33] 150 U. S. 312, 14 Sup. Ct. Rep. 99.

[34] 97 U. S. 110.

[35] L. R., 6 Ch. App. 397; affd. under name of *Towle* v. *White*, 21 W. R. 425.

law in cases of this sort.[36] But the following of "State law" cannot wholly cramp the ingenuity of the judicial mind, and the conflict of opinion which, as we believe, exists among the circuits on the points under discussion, cannot wholly be explained away by the hopless irreconcilability of various States' laws.

§ 177. The same — Bush v. Storage Co.

In *Bush* v. *Export Storage Co.*[37] the bankrupt, a car manufacturing company, agreed to make certain cars for a construction company. The purchaser was given the option to furnish certain parts and equipment which the builder agreed to accept and pay for at the prices therein named. These parts were shipped to the builder and bills therefor were sent charging the same at contract prices. But the practice under each contract was that the prices of the parts furnished was deducted from the price of the car when the same was delivered. It was held that this transaction was one of sale and that each part as it was delivered to the builder was sold to it. The court said:

> "The Santa Fe Land & Improvement Co. placed the property in the possession and under the control of the bankrupt and clothed the bankrupt with the apparent ownership of the property without any restriction or limitation in the contract or otherwise calculated to protect itself or others dealing with the Southern Car & Foundry Co. as innocent purchasers, from the possibility of just such wrong and hardship as must now fall upon some one * * *. It must be

[36] See ch. IV.

[37] D. C. Tenn., 136 Fed. 918, 14 Am. B. R. 138.

acknowledged that the case is close and doubtful. If upon the whole of the evidence the proper interpretation of the contract was still left doubtful there is authority for the doctrine that this doubt would be resolved against the maker of the contract in favor of an innocent purchaser."

§ 178. **The same — Cases in the Fourth Circuit.**

There are three interesting recent cases in the Circuit Court of Appeals, Fourth Circuit.[38]

In each case a manufacturer of machinery consigned the same to the bankrupt under an agreement by which the bankrupt received and stored the machines and from time to time shipped them out under orders from the consignor. The machines were not charged to the bankrupt nor invoiced as part of its stock, but it was paid an agreed price for storage and transfer. It had the privilege of selling the machines to its own customers at certain prices and sales so made were charged to it. In each case it was held that the transaction was valid as against the bankrupt's creditors. The decisions profess to be based entirely on the law of North Carolina. In *Wood Co.* v. *Eubanks*,[39] and *Corbitt Buggy Co.* v. *Ricaud*,[40] Pritchard, J., and Morris, J., delivered concurrent opinions. In the first case Pritchard, J., says:

"There is an unbroken line of decisions of the Supreme Court of North Carolina construing contracts similar to the one relied upon by the petitioner in this instance, in which it is held that

[38] *Walter Wood Co.* v. *Van Story*, 171 Fed. 375, 22 Am. B. R. 740; *Walter Wood Co.* v. *Eubanks*, 169 Fed. 929, 22 Am. B. R. 307; and *Corbitt Buggy Co.* v. *Ricaud*, 169 Fed. 935; 22 Am. B. R. 316.

[39] 169 Fed. 929, 22 Am. B. R. 307.

[40] 169 Fed. 935, 22 Am. B. R. 316.

such an instrument is neither a mortgage nor a conditional sale, but that it is a contract which creates a trust, and is, therefore, not required to be registered. That under its provisions the vendee holds the property or the proceeds resulting from the sale thereof in trust for the vendor, and that the right to the possession of the said property or the proceeds of the sale of the same may be enforced against a creditor or the purchaser by the vendor at any and all times."

Morris, J., says:

"I concur upon the ground that the agreement between the vendor and the vendee created a trust as to the proceeds of the goods which, under the settled law of North Carolina, is valid as against the trustee in bankruptcy. And as the proceeds are represented by notes and an account, which are identified in the hands of the trustee the vendor is entitled to them."[41]

In the second case Morris, J., says:

"We take it to be the settled law of North Carolina with regard to conditional sales, as with chattel mortgages, that although unrecorded they are good as between the parties and as against creditors who have no specific liens, and are therefore good as against the bankrupt's trustee."[42]

[41] *Wood Co.* v. *Eubanks,* 169 Fed. 929, 22 Am. B. R. 307.
[42] *Corbitt Buggy Co.* v. *Ricaud,* 169 Fed. 935, 22 Am. B. R. 316.

In the third case[43] the agreement as construed by Pritchard, J., seemed to be a memorandum transaction as defined by Hough, J., in *In re Schindler*,[44] except that it gave the bankrupt meanwhile the right to sell to other parties. He said:

> "While it is true that the bankrupt, under the option which he held to purchase a portion of this stock of machinery, was afforded the right to sell and dispose of the same, yet there was nothing pertaining to the option which could be construed to mean that he had an option to purchase the entire stock or any particular machines belonging to the stock; but on the other hand it clearly appears that under the option he only had the right to purchase from the petitioner such machines as he might need on occasions when there was a demand from a customer for machines which he did not have in his own private stock."

Thus the court disposed of the question as to machines remaining on hand. As to moneys on hand received from the sale of machines, Pritchard, J., thinks that the court disposed of that point in *Wood Co.* v. *Eubanks*,[45] already discussed.

§ 179. The same — The Eighth Circuit.

Of a like nature are two cases decided in the Eighth Circuit.[46]

[43] *Wood Co.* v. *Van Story*, 171 Fed. 935, 22 Am. B. R. 740.
[44] *Supra.*
[45] 169 Fed. 929, 22 Am. B. R. 307.
[46] *In re Columbus Buggy Co.*, 143 Fed. 859, 16 Am. B. R. 759; *In re Smith & Nixon Piano Co.*, 149 Fed. 111, 17 Am. B. R. 636.

§ 180. **Criticism.**

The mantle of "State law" may cover these decisions. Nothing else can justify them. Why a thing should be valid against creditors merely because it is a "trust" involves a judicial playing with words that long ago passed out of fashion.

Is not the following from Judge Hough apposite?

> "If this method of openly doing business is legal the defendants must prevail, but legality is not to be determined by words: a formal conveyance in fee may be but a mortgage and will not be saved by the strongest *habendum* clause ever penned; and where fraud, whether by actual deceit or legal misnomer, is averred and proved, the rights of parties are to be judged by their substantial position towards each other, and not by the label they put on their transactions."[47]

§ 181. **Walther v. Mercantile Co.**

Walther v. *Williams Merc. Co.*[48] is of another color. The mercantile company entered into a contract with Walther & Williams, wherein it was provided that Walther & Williams should take over the stock of the mercantile company at an inventoried price, and for the period of one year from the date of the agreement might make sales from such stock to customers of Walther & Williams in the ordinary course of trade, replenishing the stock from time to time as sales were made therefrom with goods of a like nature and description and of a value equal to the original inventoried value of the goods taken over by

[47] *Ludvigh* v. *Am. Woolen Co.*, 176 Fed. 145, 23 Am. B. R. 314.
[48] C. C. A., 6th Circ., 169 Fed. 270, 22 Am. B. R. 328.

Walther & Williams under the contract. The difference between the price at which Walther & Williams sold the original inventoried articles and the prices at which they could replace them represented their profits on sales to their customers, out of which profits a certain percentage was payable over to the mercantile company. At the expiration of the contract period Walther & Williams contracted to return to the mercantile company that portion of the original invoice goods then on hand, together with such goods as had been substituted for the original goods sold, in all equaling in value the value of the original stock taken over by them at the time of entering into the contract. All other terms and conditions of the contract were incidental to this main idea, and the court held that the contract constituted a bailment. The trustee brought his bill on the theory that the contract constituted a sale, but the district court held that the contract constituted not a sale but a bailment, and in this it was affirmed by the Circuit Court of Appeals. Under the law of Michigan this contract was one of bailment. It contemplated the bailing of a certain stock of goods by the Mercantile Company with Walther & Williams for a definite period. During the contract period the bailee had the right to sell some or all of the bailed articles, being obligated, however, to replace them with goods of a like nature and value, so that, at the end of the contract period, the bailee was to return to the bailor either the original stock of goods turned over to him, or some portion of the original stock of goods, plus substituted articles of the same nature and value, or possibly an entirely new stock of goods of the same nature and value for such original stock, as the bailee, under the terms of the contract, had the right to substitute for

the original articles. This seems to carry the idea of a bailment pretty far, but it is valid under the local law of Michigan, and the Federal court applied that law.

§ 182. In re Galt and other cases.

In *In re Galt*,[49] the contract provided that the bankrupt must upon each sale, remit all of the proceeds of the sale; "all cash is to be remitted not latter than the day following the sale; notes to be transmitted every thirty days * * * the surplus is to be returned to Galt when and in proportion to the amount collected."[50]

The court notes this fact in holding that the agreement was one of bailment, and says:

> "The proceeds, whether in cash or in notes of the purchaser, were to be immediately returned to the company; the notes being guaranteed by Galt. This was a *del credere* commission and not a sale."

In *In re Taft*,[51] the case was clearly a consignment. The only point claimed by the trustee was that as the bankrupts guaranteed the solvency of the persons to whom the goods were sold, this constituted a bailment. Clearly, however, this was a *del credere* commission, and the court so held.

In *In re Flanders*,[52] the court thus distinguishes cases where a bailment was held to be a consignment, that "in each of these cases the advances stipulated to be made, by the supposed consignee were to the

[49] C. C. A., 7th Circ., 120 Fed. 64, 13 Am. B. R. 575.
[50] 120 Fed. 6.
[51] C. C. A., 6th Circ., 133 Fed. 511, 13 Am. B. R. 417.
[52] C. C. A., 7th Circ., 134 Fed. 560, 14 Am. B. R. 27.

entire value of the goods shipped, and the court found that the transactions were sales sought to be disguised under the cloak of bailment." The cases cited were *Chickering* v. *Bastress*,[53] and *Peoria Mfg. Co.* v. *Lyons*.[54]

In *John Deere Plow Co.* v. *McDavid*,[55] the agreement expressly entitled the claimant to require the goods to be returned. The court says:

> "We think it was an agency contract. It is not a contract in which the consignee can sell at any price on any terms he may choose, but, as we understand it, it is a contract on consignment, of goods to be sold on commission by the consignee as agent for the consignor for cash."

§ 183. Ludvigh v. Woolen Co.

The latest case on this head is *Ludvigh* v. *Am. Woolen Co.*[56] There the defendant, desiring to maintain the outlet for its products afforded by the continuance in business of a firm of jobbers of doubtful stability, conceived the idea of forming a corporation, substantially all of whose stock was issued to the jobbers in consideration of a mortgage on real estate owned by them. Then the defendant entered into a so-called consignment agreement with this corporation, which the jobbers guaranteed, and, as collateral therefor, the jobbers put up all their share holdings in the corporation. The consignment agreement, as construed by the court, obliged the jobbers to pay the invoice price as stated with each delivery of goods; and, by its terms, as judicially construed, the consignor was not obliged to take back the goods in the event of

[53] 130 Ill. 206.
[54] 153 Ill. 427.
[55] C. C. A., 8th Circ., 137 Fed. 802, 14 Am. B. R. 659.
[56] 176 Fed. 145, 23 Am. B. R. 314.

the jobbers being unable to sell them. The situation with respect to the corporate entity thus interposed between the consignor and the real consignees, the jobbers will be discussed elsewhere. Hough, J., held that the transaction, as against the creditors of the jobbers, who became bankrupt, constituted a sale, saying:

> "Let this matter, therefore, be tested by the written contracts. From them alone it is apparent that in substance and effect Horowitz & Son were obliged to pay the invoice price for every yard of goods delivered to the Niagara Company sooner or later, whether the merchandise was sold or not, and even if it were burned or stolen the Woolen Company was entitled to sue both father and son for such invoice price or any deficiency thereof, and if such suit were not desired the obedient directors of the Niagara Company could foreclose on the Horowitz real estate and so put the Niagara Company in funds to pay *pro tanto*. In short the Woolen Company so arranged matters that while carefully avoiding all such words as sale or conveyance, and procuring Horowitz to agree to such avoidance, it was from the moment of delivering goods contractually entitled to recover from Horowitz the sale price of those goods, and could not be compelled to resume possession of any of them; yet it always claimed, and now claims, to own outright what it would not take back and could sue for the price of."

§ 184. **The result.**

That brings us back to the main thesis. The test after all, is the true meaning of the contract, and

mere words or phraseology should not obstruct the search for that meaning. "Sale" or "Sold" do not alone necessarily import a sale;[57] but, equally as well, "consign" and "bail," though used ever so much, cannot always carry the day.[58] What did the parties really mean? Was the good faith of the transaction clear? Those are the real points for decision in every such case, and solution must be found in (1) the actual contract drawn up,[59] and (2) the conduct and dealings of the parties with each other after the execution of the contracts.[60]

§ 185. A case decided on categories — Bryant v. Dry Goods Company.

It remains to mention a case which, like *Charavay* v. *York Silk Co.*,[61] hereafter discussed, went off on a narrow question of categories. That was *Bryant* v. *Swofford Dry Goods Co.*[62]

Swofford Bros. & Co. entered into a contract with Newton & Co., whereby it was agreed that Swofford Bros. & Co. would sell and deliver to Newton & Co. such goods as Newton & Co. might select by sample, or from their stock in Kansas City, and ship the same to Newton & Co. at East Lewiston, Missouri, from which place they were not to be removed without

[57] *Dows* v. *Bank*, 91 U. S. 616; *Sturm* v. *Boker*, 150 U. S. 312, 14 Sup. Ct. Rep. 99; *Schenck* v. *Saunders*, 13 Gray, 37; *In re Smith & Nixon Piano Co.*, 149 Fed. 111, 17 Am. B. R. 636.

[58] *In re Wells*, 140 Fed. 752, 15 Am. B. R. 419; *In re Penny & Anderson*, 176 Fed. 141, 23 Am. B. R. 115; *Ludvigh* v. *Am. Woolen Co.*, 176 Fed. 145, 23 Am. B. R. 314.

[59] *Ludvigh* v. *Woolen Co.*, 176 Fed. 145, 23 Am. B. R. 314.

[60] *In re Smith & Nixon Piano Co.*, 149 Fed. 111, 17 Am. B. R. 636.

[61] 170 Fed. 819.

[62] 214 U. S. 279, 29 Sup. Ct. Rep. 614.

the written consent of Swofford Bros., save that Newton & Co. had the right to sell the goods in the ordinary course of business, but not otherwise. It was further provided that Newton & Co. were to keep the goods fully insured for the benefit of Swofford Bros. After Swofford Bros. & Co. had delivered to Newton & Co. a consignment of goods under this contract, Newton & Co. became bankrupt, but just prior to their bankruptcy, returned to Swofford Bros. & Co. a portion of the goods originally delivered to them, and notes and book accounts of value equivalent to the remainder of the invoice value of the original stock delivered under the contract. The receiver of Newton & Co. demanded from Swofford Bros. & Co. the return of the goods and the notes and book accounts received by them from the bankrupts. Swofford Bros. & Co. refused to so deliver them, but subsequently they and the receiver entered into a stipulation, whereby it was provided that the goods and the notes and book accounts returned by Newton & Co. to Swofford Bros. represented part of the goods originally delivered by Swofford Bros. to Newton & Co., and the proceeds of sale of the balance. The receiver subsequently sold the goods and Swofford Bros. & Co. intervened to reclaim these proceeds in the hands of the trustee, who succeeded himself as receiver. It was found as a fact that (a) the contract was not filed or recorded; (b) that goods of a certain value were delivered by Swofford Bros. & Co. to Newton & Co. under and pursuant to the contract; (c) that the goods so delivered were placed with other goods obtained from other parties by Newton & Co., but were of such a character and obtained such marks as to render them capable of being identified and separated.

The controversy was presented by the intervening

petition of Swofford Bros. Dry Goods Co., the trustee's answer thereto and the reply of the Dry Goods Co.

On the trial of the action in the District Court, the issues seem to have been narrowed to the question of whether the contract entered into between Newton & Co. and the Swofford Dry Goods Co. constituted a *chattel mortgage* or a *conditional sale,* for, under the laws of Arkansas, (and it must be remembered that the local law governs in a court of bankruptcy in a question of this nature), a chattel mortgage must be filed and recorded, whereas a conditional sale need not be filed or recorded, and is valid even though the conditional vendee has the right to dispose of the subject matter of the conditional sale in the ordinary course of trade. The district judge held that the contract constituted a chattel mortgage, and was, under the doctrine of *Twynes Case,*[63] fraudulent and void. On appeal to the Circuit Court of Appeals, however, this court reversed the order of the District Court and held that the contract constituted a conditional sale valid under the laws of Arkansas, and that, being valid under the laws of Arkansas, it could not hold to be invalid under the Bankruptcy Act; that the trustee stood in no better position than the bankrupt; and that Swofford Bros. Dry Goods Co. were entitled to the proceeds of the sale made by the trustee pursuant to the terms of the stipulation entered into between them and the trustee. On appeal to the Supreme Court of the United States the decision of the Circuit Court of Appeals was affirmed, Mr. Justice Moody delivering the opinion of the court.

[63] 3 Co. Rep. 80b.

§ 186. **Its narrowness.**

It is to be noticed, however, that all through this case the narrow issue of whether or not the contract constituted a chattel mortgage or a conditional sale was the only one presented. The action was not brought on the equity side of the court, nor was the court asked to raise an estoppel to circumvent fraud. The sole question was under which category did this contract fall, and in determining this question the whole issue was decided, for if the contract was a conditional sale, then the local law of Arkansas applied and it was valid. If it was a chattel mortgage the local law of Arkansas would likewise have applied, and it would have been invalid for want of record.

Had the goods been indistinguishably mingled with other goods of the bankrupts, perhaps the result would have been different. But the conduct of the parties under the contract, and the issues of law on the contract itself were confined to a discussion *a priori.*

CHAPTER XV.

"TRUST RECEIPTS."

§ 187. The subject.

The matters here below discussed really belong to the preceding chapter, but for convenience of treatment are dealt with separately.

§ 188. The trust receipt system.

There are many interesting decisions upon the so-called trust receipt system for the importation or moving of merchandise. The transaction in brief is generally this: If one desires to import merchandise from abroad or from a distant place and has not the money with which to pay for it, he applies to a banker for an advance on the collateral constituted by the goods purchased. This banker, then, through his correspondent, buys the goods at their place of sale and brings them to the importer. Upon their arrival they are delivered to the importer under a so-called trust receipt, which gives the importer the right to sell the goods to such persons as he may select, and at such prices as he may determine, but paying to the banker the amount which had been advanced on the credit of the goods, it being stipulated that the banker until the time that the goods are sold retains the title thereto. The written instruments used in such cases vary in language, but their essential effect is about as above stated. Whether such a transaction is one of conditional sale, or constitutes an agreement whereby the banker reserves merely an equitable lien upon the goods after their delivery to the importer, has for some time disturbed the

courts. In most of the cases the agreement expressly reserved the legal title to the goods in the banker until payment was made by the importer. It must be noted that at the outset of the transaction title to the goods passed not to the importer but to the banker who, through his correspondent, purchased the goods at their place of sale, taking the documents of title thereto.

§ 189. A categorical description.

Speaking categorically, this would constitute a contract of conditional sale. Adopting the language of the agreements there would be no point where the title to the property as between the parties was for any moment in the debtor. Consequently, the goods while in the importer's hands were simply bailed to him, and the transaction was, therefore, one of conditional sale.[1]

§ 190. The earlier cases.

The earlier cases on the subject contain language which seems to recognize this view. Thus in *Farmers' Bank* v. *Logan*[2] the transaction is thus described in a similar arrangement for the bringing of goods from the West to New York:

> "At the outset, as one of the first steps in the process, the legal title is lodged in the plaintiff not to leave it until the payment by Brown of the draft. Thus the case is kept out of the law governing the relations of pledgor and pledgee. The

[1] *Smith* v. *De Vaughan*, 82 Ga. 574, 576; *Tweedy* v. *Clarke*, 114 App. Div. 296, 298; *Grant* v. *Skinner*, 21 Barb. 581; *Jones on Chattel Mortgages*, 5th ed., § 26a.

[2] 74 N. Y. 568.

plaintiff was not the pledgee of the property of Brown. It had a right to it, not the qualified and special property of one holding as a security a chattel belonging to another. It had the legal title under an agreement to transfer it on demand being made."[2]

This is even more strongly stated by Finch, J., in *Moors* v. *Kidder*:[4]

"The doctrine of *Farmers' Bank* v. *Logan*[5] stated was in substance that where a commercial correspondent, however set in motion by a principal for whom he acts, advances his own money or credit for the purchase of property and takes the bill of lading in his own name, looking to such property as the reliable and safe means of reimbursement up to the moment when the original principal shall pay the purchase price, he becomes the owner of the property instead of its pledgees, and his relation to the original mover in the transaction is that of an owner under a contract to sell and deliver when the purchase price is paid."

§ 191. A later restriction.

In *Drexel* v. *Pease*,[6] however, the court thus qualifies the idea expressed in the previous cases:

"The correspondent's position is one of ownership so far only as is necessary to secure him

[2] *Moors* v. *Kidder*, 106 N. Y. 32; *Moors* v. *Wyman*, 146 Mass. 60; *Dows* v. *National Bank*, 91 U. S. 618.

[4] 106 N. Y. 32.

[5] *Supra.*

[6] 133 N. Y. 129.

for the advances he made upon the merchandise described in a bill of lading, and in such a case as this he is bound to sell upon receipt of the purchase price from the principal, or, in other words, upon receipt of the amount he advanced upon its credit. In no other sense is the correspondent the owner of the property."

§ 192. **The transaction as a conditional sale.**

In three cases in different jurisdictions, however, the transaction was unqualifiedly held to be one of conditional sale as distinct from one where an equitable lien on the goods merely was left in the banker after he allowed the importer to take the goods.[7] In two of these cases, *New Haven Wire Co. Cases*[8] and *Mershon* v. *Moors*,[9] the importer's business had passed into the hands of a receiver, and the banker sought to reclaim in specie the goods which had been delivered to the importer under such a trust receipt. In each case the court appeared to think that if the transaction was one of conditional sale the importer could retake the property, but if it was one of mortgage or lien, then, inasmuch as the importer was allowed to deal with the goods as his own, selling them at such prices as he might elect, and paying only to the banker a fixed amount representing his advances, the transaction would be void as against the importer's creditors. The theory of both the majority of the court who held the transaction to be one of conditional sale and of the dissenting judge who considered it one of mortgage and therefore void as against

[7] *New Haven Wire Co. Cases*, 57 Conn. 352, 5 L. R. A. 300; *Mershon* v. *Moors*, 76 Wis. 502; *Moors* v. *Drury*, 186 Mass. 424.

[8] *Supra.*

[9] *Supra.*

the importer's creditors, is well brought out in the opinion of the latter rendered in the *New Haven Wire Co. Cases:*[10]

> "We agree, I think, that if this is a mortgage it is invalid as against creditors in consequence of the delivery of the property to the Wire Company * * *. They (counsel for the banker) knew that the moment they conceded that they are mortgagees they must also concede that when they parted with the possession of the wire with permission to treat it in all respects as its own, that moment their lien on the goods as against creditors was irrecoverably gone."

§ 193. A distinction without a difference.

It is quite true, of course, that if the banker's right was merely that of a mortgagee it would not avail as against the creditors of the mortgagor, inasmuch as the mortgage allowed the mortgagor to deal with the property as his own. In *In re Liberty Silk Co.*,[11] the trust receipt was couched in the language of lien instead of conditional sale, and Hough, J., held that it was void as against the mortgagor's creditors. It is conceived, however, that the distinction made in the *New Haven Wire Co. Cases*, and the Wisconsin decision, which rests upon the same point,[12] would be without a difference.

§ 194. Not in Connecticut.

In Connecticut, however, where the *New Haven Wire Co. Cases* arose, the courts go very far in permitting consignment arrangements which, in New

[10] *Supra.*

[11] 152 Fed. 844; 18 Am. B. R. 582.

[12] *Mershon* v. *Moore*, 76 Wis. 502.

York, are not permitted under the cases discussed in the last chapter.[13]

§ 195. But in other jurisdictions.

In most jurisdictions the same rule would apply to both conditional sale transactions and mortgage transactions, viz., that where the debtor is permitted to deal with the property as though it were his own so that his creditors would most likely be deceived into believing that such was the fact, the mortgagee or vendor, however be the case, is estopped to assert his right in the event of the debtor's insolvency. It is, therefore, believed that the doctrine of *In re Garcewich*[14] would in such jurisdictions apply to the case of the *Liberty Silk Co.* even though the trust receipt had not expressed itself in the language of mortgages. Indeed, the judgment of Hough, J., as delivered in the latter case[15] takes this line, the learned judge saying:

> "It must be admitted that no actual fraud is shown or suspected in this transaction, and that the courts of this state have gone far in upholding the validity of hypothecations of personal property even where the goods hypothecated were to be turned into money by the mortgagor, bailee, or conditional vendee, provided it was also agreed that the proceeds of such sale or use were to be applied in diminution of the debt secured by the goods themselves.[16] But I am not

[13] *Harris* v. *Coe*, 71 Conn. 161.

[14] 115 Fed. 87, 8 Am. B. R. 49.

[15] *In re Liberty Silk Co.*, 152 Fed. 844, 18 Am. B. R. 582.

[16] *Prentiss Tool, etc., Co.* v. *Schirmer*, 136 N. Y. 305, 32 N. E. 849, 32 Am. St. Rep. 737.

aware that it has been doubted since *Southard* v. *Benner*[17] that a right existing in a chattel mortgagor to sell the mortgaged property and use the proceeds thereof generally in his own business is (however honest in intent) a fraud upon the law. The wholesome rule is summarily stated in *In re Garcewich*,[18] that when property is delivered to a vendee for consumption or sale, or to be dealt with in any way inconsistent with the ownership of the seller, the transaction cannot be upheld as a conditional sale and is a fraud upon the creditors of the vendee. That rule, in my judgment, applies to this case. While I think as above indicated that the transaction is really a mortgage, and as such void for want of filing, yet it makes no difference whether it be denominated in one way or another, it still remains true that the filatures in question were delivered to the bankrupt with obvious intent that they should be used and consumed in the ordinary course of that bankrupt's business, and for the benefit thereof. Secret liens are to be discouraged, and where, even innocently, vendors seeking to create such liens permit so obvious a badge of fraud as here appears to exist in their contracts, they must take the legal consequences, and the matter is not bettered by a name. An equitable lien which involves a fraud upon the law is none the less obnoxious because so different in form from the better known mortgage or conditional sale as hardly to fall under either well-known category."

[17] 72 N. Y. 424.

[18] 8 Am. Bankr. Rep. 149, 115 Fed. 87, 53 C. C. A. 510.

§ 196. Moors v. Drury.

Whether or not the transaction is one of conditional sale or mortgage is therefore a minor issue. Apropos of that, however, it might be well to note that in addition to the *New Haven Wire Co. Cases* and *Mershon* v. *Moors*[19] there is the authority of *Moors* v. *Drury*[20] that the transaction technically is a conditional sale and not a mortgage. In that case the customer was adjudged an insolvent debtor, whereupon the banker sold the goods in open market and filed a proof of claim for the difference. The claim was objected to under the Massachusetts Insolvency Act's provisions that no mortgagee, lienor or pledgee could prove his claim unless first the property held under the lien, mortgage or pledge be surrendered for sale under an order of the court. It was held, however, that the transaction was one neither of lien, mortgage nor pledge, and that, therefore, the claim was provable, the court saying that the banker was "the owner and not the mortgagee or pledgee." It is difficult, however, to justify this decision if it be remembered that in the case of a conditional sale the retaking of the goods by the vendor avoids the consideration for a sale and does not entitle him to a deficiency claim should he resell the goods at a loss.[21]

§ 197. The transaction not a conditional sale — Charavay v. York Silk Co.

This well-known rule in transactions of conditional sale was of importance in *Charavay* v. *York Silk Mfg.*

[19] *Supra.*

[20] 186 Mass. 424.

[21] *Earle* v. *Robinson,* 91 Hun, 363; affd., 157 N. Y. 683; *Cooper* v. *Paine,* 111 App. Div. 785; affd., 190 N. Y. 512; *Minnesota Harvester Works* v. *Hally,* 27 Minn. 495; *Brewer* v. *Ford,* 59 Hun, 17; affd., 126 N. Y. 643.

Co.[22] In that case the question was whether a bank, having retaken the goods, could prove for a deficiency claim against an insolvent's estate. The previous transactions in the case prevented the receivers from asserting the invalidity of the transaction as against the insolvent's creditors, and they were confined to the argument that, the bank having retaken the goods, the matter was ended, because the transaction was one of conditional sale. But such was held not to be the character of the transaction, the court on the contrary saying that " the title is at any and all times a security title and no more, and it is incident and subordinate to the general obligation of the purchaser to repay the banker his advances." As we have said, it would not matter in New York whether the transaction technically were one of conditional sale or of mortgage, in so far as its validity as against the importer's creditors is concerned. If the transaction is one of mortgage, then *In re Liberty Silk Co.*[23] is a direct authority that it is void as against the importer's creditors, and *Charavay* v. *York Silk Mfg. Co.*[24] is equally direct that the transaction is exactly of that class.

§ 198. A curious extension of leniency.

In this connection, attention might be called to a rather curious extension of leniency to such secret arrangements on the one hand, which, strangely enough, seeks support in a very narrow restriction of quite another nature. As we have seen, in a few States, notably Pennsylvania and Illinois, it was, at a very early date, held that a conditional sale, pure and

[22] 170 Fed. 819.
[23] 152 Fed. 844, 18 Am. B. R. 582.
[24] 170 Fed. 819.

simple, was void as against the creditors of the vendee, because it would be presumed that the latter relied on the ostensible ownership of the property by their debtor. As the Supreme Court has pointed out,[25] the doctrine thus enunciated originated in a misapprehension of the Statute of James, and, in fact, was not even in accord with the decisions under that statute. As we have seen, a conditional sale was valid under the Statute of James, as the courts finally construed it, because the arrangement was honest in its inception. When it came, on the other hand, to trust receipts of the kind discussed, the Pennsylvania courts were eager to allow such arrangements to stand even as against the creditors of the vendee. The result was that while a conditional sale is void as against the vendee's creditors in Pennsylvania, a so-called bailment agreement is valid there.

§ 199. The Pennsylvania rule.

Trust receipt agreements have, therefore, been upheld in Pennsylvania, on the point that the transaction did not constitute a conditional sale, but was merely a bailment.[26]

[25] *Harkness* v. *Russell,* 118 U. S. 663, 7 Sup. Ct. Rep. 51.
[26] *Brown* v. *Billington,* 163 Pa. St. 76.

CHAPTER XVI.

THE CORPORATE ENTITY.

§ 200. The importance of the conception.

Several recent decisions of the Supreme Court have marked a tendency on its part to return to the strict conception of the corporate entity, whose domain has suffered many encroachments of recent years.[1] As Mr. Justice Holmes has said:

> "Philosophy may have gained by the attempts in recent years to look through the fiction to the fact and to generalize corporations, partnerships and other groups into a single conception. But to generalize is to omit, and, in this instance, to omit one characteristic of the complete corporation, as called into being under modern statutes, that is most important in business and in law. A leading purpose of such statutes and of those who act under them is to interpose a non-conductor through which, in matters of contract, it is impossible to see the men behind."[2]

§ 201. It cannot be ignored.

The case last cited undoubtedly signifies a position of our highest court which must always be kept in view. The corporate entity, as the learned jurist quoted above impresses on us, is not a relic of the past, to be gradually worn away by the attrition of fine distinctions.

[1] *Donnell* v. *Herring-Hall-Marvin Safe Co.*, 208 U. S. 267, 28 Sup Ct. Rep. 288; *Old Dominion Copper Co.* v. *Lewisohn*, 210 U. S. 206, 28 Sup. Ct. Rep. 634.

[2] *Donnell* v. *Herring-Hall-Marvin Safe Co.;* and see *Woodruff* v. *Shirner*, 174 Fed. 584.

§ 202. Two exceptions.

But it is none the less true, that, as an eminent authority has recently expressed it, there are two exceptions to this rule of dominance of the corporate entity, viz.:

> "(1) The legal fiction of distinct corporate existence will be disregarded, when necessary to circumvent fraud; (2) It may also be disregarded in a case where a corporation is so organized and controlled, and its affairs are so conducted, as to make it merely an instrumentality or adjunct of another corporation."[3]

Indeed, the Supreme Court itself has twice lately disregarded the corporate entity where it was availed of to secure the jurisdiction of the circuit court.[4] In each of these cases it was held that the attempt to secure the jurisdiction of the circuit court, for diversity of citizenship, by the creation of a corporation which, in reality, would have no interest in the subject-matter of the suit, is ineffectual.

§ 203. The dummy corporation and reputed ownership.

The question with which we are concerned is whether the doctrine of reputed ownership can be avoided by the creation of a corporation, in whose dead hand the possession of the property will rest, but which is entirely controlled either by the true

[3] Noyes, J., in *In re Watertown Paper Co.*, 169 Fed. 252, 22 Am. B. R. 190.

[4] *Miller & Lux* v. *East Side Canal Co.*, 211 U. S. 293, 29 Sup. Ct. Rep. 111; *Southern Investment Co.* v. *Walker*, 211 U. S. 603, 29 Sup. Ct. Rep. 211.

owner or the insolvent. It is believed that the authorities answer this question in the negative.

§ 204. The same and the Statute of Fraudulent Conveyances.

The Statute of Fraudulent Conveyances certainly cannot thus be avoided. It has repeatedly been held that the transfer of an insolvent's business to a corporation organized and controlled entirely by him for that purpose, is void as against his existing creditors.[5] Technically void is such a corporation. The plaintiff creditor, in such a case "has the right to disregard the corporation as a void thing."[6] And so a conveyance by one insolvent corporation to a new corporation in exchange for the latter's stock, is void as against the grantor's creditors.[7]

§ 205. The corporation as a mere instrumentality of another.

So, where, to use the words of Noyes, J., above quoted, the corporation is a mere instrumentality of another. A very interesting case on this head is *In re Muncie Pulp Co.*[8] There a receivership was extended to the assets of a company which had been organized by the bankrupt corporation solely to exploit one branch of the latter's business, the bankrupt owning all the stock of the agent company thus constituted. The

[5] *In re Hoffman*, 102 Fed. 979, 4 Am. B. R. 331; *Bank* v. *Trebein*, 59 Ohio St. 316.

[6] *Booth* v. *Bunce*, 33 N. Y. 139.

[7] *Booth* v. *Bunce*, 33 N. Y. 139; *Montgomery Co.* v. *Disnelt*, 133 Pa. St. 585; *Hibernia Ins. Co.* v. *Transportation Co.*, 13 Fed. 516; *Du Vivier* v. *Gallice*, 149 Fed. 118, 17 Am. B. R. 557; *York Mfg. Co.* v. *Brewster*, 174 Fed. 566, 23 Am. B. R. 474.

[8] 139 Fed. 546, 18 Am. B. R. 56; writ of certiorari denied, 202 U. S. 621.

court, speaking through Coxe, J., pertinently observes that to permit this agent company to go hence with its assets would be "to sanction a fraud upon the creditors of the Pulp Company."

§ 206. The legal entity cannot be created as a shield.

Nor can one with impunity organize a corporation in order that, by doing certain contemplated things in its name, he may escape the legal consequences, whatever they may be.[9] In *Brundred* v. *Rice*,[10] the defendants individually were held liable for moneys received from a common carrier under an agreement, to which they were not a party, whereby the carrier agreed to pay a rebate on all of a certain class of freight receipts in a certain territory, to a corporation of which the defendants held all the stock. The court said:

> "If, however, it was organized by the promoters, the defendants, simply for the purpose of consummating the illegal agreement and shielding themselves from the consequences of receiving the illegal exactions made under it, the act of incorporating can be of no avail to them as a defense. * * * Deeds and records made in the most solemn form are set aside and held for naught when shown to have been effectuated for the purpose of fraud; and there is nothing so sacred in a certificate of incorporation as to take it out of the reach of this maxim."

[9] *Brundred* v. *Rice*, 49 Ohio St. 640; *Holbrook* v. *Perkins*, 147 Fed. 166; *Christian Grocery Co.* v. *Fruitdale Co.*, 121 Ala. 340; *McNeill Bros.* v. *Crucible Steel Co.*, 207 Pa. St. 493; *Cawthra* v. *Stewart*, 59 N. Y. Misc. 38.

[10] 49 Ohio St. 640.

So in *Holbrook, Cabot & Rollins Corp.* v. *Perkins*,[11] the court said:

> "Assuming the valid creation of the Atlantic Construction Co. as a distinct corporation, assuming the regularity in point of form of the execution of a document which purported to be a contract between two corporations, there was still open the question whether there was in fact, as distinguished from mere form, a contract — whether there were in fact, as distinguished from form, two distinct parties making an agreement upon mutual considerations."

§ 207. **The same — In re Watertown Paper Co.**

The case of *In re Watertown Paper Co.*[12] brings this out very clearly. In that case the Remington Pulp Co. presented a proof of claim against the estate of the bankrupt, Watertown Paper Co. The trustee objected to the claim on the ground that the two companies were really one. It was held that the corporations were so distinct that the one could prove against the estate of the other. Noyes, J., who delivered the opinion, points out that, although the stockholders of the two companies were largely the same, and both companies were under the same management, yet they were distinct. The Pulp Company, indeed, had paid the bills of the other company. But, as Noyes, J., points out, the money for these bills came from the stockholders of the Pulp Company. It could not be denied that if these stockholders had themselves paid the bills they could prove against the estate of the Watertown Company for the money paid to its use. He says:

[11] 147 Fed. 166.
[12] 169 Fed 252.

> "The Paper Company did not in any legal sense furnish the money to build the Pulp Company's plant. It is true that it actually advanced the funds; but it did so for the account of the Remingtons. It was simply the conduit through which the Remingtons' money passed to meet their obligations."

The learned judge points out that the only two instances where a corporate entity will be ignored are (1) where it is necessary to circumvent fraud, and (2) "where a corporation is so organized and controlled and its affairs are so conducted as to make it merely an instrumentality or adjunct of another corporation." Under the first exception, as he shows "the cases are numerous which hold that a person cannot transfer his property to a corporation to defraud its creditors nor employ a separate corporate existence to evade his liabilities." As an illustration of the opposite kind of case he cites *In re Muncie Pulp Co.*,[13] to which we have referred.

§ 208. The result of these authorities.

These authorities are of value in this, that though nothing can override the *fact* of the legal entity of a corporation, yet that entity is no bar to the application of the ordinary doctrines illustrated above, such as master and servant, undisclosed principal, and the several liability of joint tort feasors.

§ 209. The fiction cannot avoid the doctrine of reputed ownership.

It must follow that the fiction of the corporate entity would none the more avail in a case of reputed

[13] 139 Fed. 546.

ownership. Two decisions of recent date confirm this view.[14]

§ 210. In re Rieger.

In *In re Rieger*,[15] a partnership organized a manufacturing corporation and held all its stock. The partnership itself was engaged in the commission business. The partnership was adjudged a bankrupt and an application to extend the receivership to the corporate assets was granted. The court cited *Bank* v. *Trebein Co.*,[16] and *In re Muncie Pulp Co.*[17] The court thus discussed the motive which it might be reasonable to presume animated the separation of the corporate entity from the partnership business:

> "The four individuals comprising the firm may have obtained — doubtless did obtain — a larger credit by operating in two names. That they so used whatever credit it was accorded them as to entail loss on many of those who bestowed it is manifest from the record and their admissions of insolvency."

There were no proofs of what the creditors relied on, but the court inferred it from the facts. The court proceeds:

> "To deny the individual and partnership creditors participation in the administration of so much of the bankrupt's estate as may be found in possession of the corporation, and to compel

[14] *In re Rieger*, 157 Fed. 609, 19 Am. B. R. 622; *Ludvigh* v. *Am. Woolen Co.*, 159 Fed. 761, 19 Am. B. R. 795, 176 Fed. 145, 23 Am. B. R. 314.

[15] 157 Fed. 609, 19 Am. B. R. 622.

[16] 59 Ohio St. 316.

[17] 139 Fed. 546.

such creditors to remain silent spectators until the corporate creditors shall have been paid in full out of the proceeds of the sales of the corporate property, or out of the profits of the business if it should be profitably continued, or until the corporate property is exhausted, is to deny them a right guaranteed by the Bankrupt Act and to hinder and delay them in the pursuit of their legal remedies against the bankrupts and their property, and is, consequently, fraudulent in law, however honestly the partners may have intended to deal with the creditors in case of insolvency. * * * The fiction of legal corporate entity cannot be so applied by the partners as to work a fraud on a part of their creditors or hinder or delay them in the collection of their claims and thus defeat the provisions of the Bankrupt Act. The doctrine of corporate entity is not so sacred that the court of equity looking through forms to the substance of things may not, as in the principal case, ignore it to preserve the rights of innocent parties or to circumvent fraud."

§ 211. Ludvigh v. Am. Woolen Co.

In *Ludvigh* v. *Am. Woolen Co.*,[18] the question was squarely presented. The facts of this case have been already stated.[19] In overruling the demurrer to the bill,[20] Hough, J., said:

"To my mind the question presented is this: Assuming it to be true, as asserted, that the Niagara Woolen Company, though a different

[18] 159 Fed. 796, 19 Am. B. R. 795, 176 Fed. 145, 23 Am. B. R. 314.

[19] *Supra*, pp. 143, 144.

[20] 159 Fed. 796, 19 Am. B. R. 795.

legal entity, was for business purposes but the *alter ego* of the American Woolen Company; that goods consigned to the Niagara Woolen Company were while in that company's possession intended to be held for the benefit of the American Woolen Company; that the affairs of the Niagara Woolen Company were by the procurement and consent of the American Woolen Company managed in large part by the bankrupt; that, being so managed, the Niagara Woolen Company permitted the bankrupts to trade and use the consigned stock of goods as their own to this extent, viz., to sell the same to customers of their finding or selection, to sell in the bankrupts' own name, and to make collections likewise in their own name and deposit the proceeds of the collection in whole or in great part to bankrupts' own credit — do these allegations, if true, set forth a cause of action in the trustee duly appointed, based upon an alleged scheme to hinder, delay and defraud creditors? The answer to this question is to be found in my judgment by solving one or two questions of fact, to wit: (a) Were the goods in question at the time of the transaction complained of the goods of the bankrupts? (b) If they were not as between the parties to the agreement the goods of the bankrupts, were they in the possession of the bankrupts under such circumstances as to estop the American Woolen Company and the Niagara Woolen Company from asserting ownership therein as against a trustee in bankruptcy?

"I think both of these questions are raised by the bill of complaint upon sufficient allegations of fact pleaded with sufficient artificiality. If this

were a final hearing, and all the facts were admitted as pleaded, my answer to the question last propounded would be to direct judgment for complainant. Entertaining such a view, the demurrer is overruled."

On final hearing,[21] the same learned judge thus disposed of the point:

"Holding then, as I now do, that in legal effect the delivery of the goods in question to the Niagara Company constituted a sale to that company, it remains to consider whether this finding can benefit the creditors of Horowitz. In this branch of the case I find no difficulty, although no similar litigation has been instanced. The analysis above made of the contract between the Woolen Company and the Niagara Company has assumed (for argument's sake) that the latter was an independent concern actually making contracts on its behalf and maintaining a real existence separate and apart from the Woolen Company and from Horowitz. It is, however, too plain for argument that such was not the case; if it had not been for the agreement of Horowitz & Son guaranteeing the performance of every covenant and obligation entered into by the Niagara Company and for the real estate security furnished (in effect) by Philip Horowitz as collateral to the promise of his firm, the written engagements made between the Niagara Company and the Woolen Company would have been absurdities. There was no real person for the Woolen Company to contract with, except the

[21] 176 Fed. 145, 23 Am. B. R. 314.

bankrupts, and the whole and avowed meaning and intent of the arrangement was not to consign goods to the Niagara Company, but to enable Horowitz & Son to sell goods at their own prices without owning them. If the Woolen Company could not have dealt with an independent Niagara Company in the manner it did without having its dealing result in a sale, then that situation is not bettered by the intervention between the Woolen Company and Horowitz of a paper corporation which was merely another name for the Woolen Company itself. If the Niagara Company had really been an independent concern, had itself become bankrupt with numerous creditors, and the Woolen Company had removed from its premises goods in like manner as it removed them from Horowitz's store, then for the reasons above given such creditors through their trustee could have recovered against the Woolen Company. If, however, the Niagara Company had carried on its own real and independent business through Horowitz's clerks and mingled its goods with Horowitz's goods, then it is true that Horowitz's creditors could have had no recourse against Woolen Company, whatever might have been their rights against Niagara Company, and Horowitz would then have been a stranger to the Woolen Company, however intimate might have been his relations with the Niagara Company. But when the Woolen Company in the very beginning creates the Niagara Company not for the purpose of doing business with it, but for the purpose of doing business with Horowitz, then the real substantive agreement made is not the idle form of the consignment contract with the

Niagara Company, but that which was intended as between the Woolen Company and Horowitz and expressed with prefect plainness in the latter's indemnity agreement. From what source was the Woolen Company to receive payment for its goods? From the goods themselves, if possible; but who was to sell those goods? Plainly Horowitz, and, if he could not sell them, to whose property did the Woolen Company have recourse? Nominally to the capital stock of the Niagara Company, which, however, meant no more than the foreclosure of a mortgage upon Philip Horowitz's house.

"The legal effect of this arrangement was exactly the same as that, even more plainly expressed in the consignment agreement between the Woolen Company and Horowitz of 1901, with this difference only — that so far as the paper writings are concerned Horowitz could return in 1901 goods he did not want, whereas when in 1902 the transparent window of the Niagara Company was erected between himself and the Woolen Company he was forbidden that privilege. It is highly improbable that in practice there was any such difference between the written documents as claimed. It results, therefore, that in my opinion the legal effect of the transaction shown in evidence is that at the time defendants removed the goods which are the subject of this suit, such goods had been delivered to Horowitz & Son and were in their possession in pursuance of the contracts of November 25, 1902, whereof the legal result was to render the persons to whom the goods were delivered and intended to be delivered (*i. e.*, Horowitz & Son) the vendees of the same."

§ 212. The trust fund theory — Does not apply save where creditors are concerned.

The development of the trust fund theory of corporate assets is very much in point. If it is agreed between a corporation and a subscriber that he need not, in fact, pay for his stock, that agreement, without doubt, binds the corporation. It cannot afterward repudiate such agreement and insist upon the stockholder paying for his stock, although the agreement might have been made in direct defiance of the corporation law. Not only that, but a subsequent subscriber for the stock cannot, in the name of the corporation, maintain suit to recover for the unpaid subscription. The corporation is bound by the agreement for all purposes and every stockholder of the company, subsequent or future, is likewise bound. This rule, which has existed for many years in New York[22] seems absolutely clear on principle, although the English rule[23] and that of Massachusetts[24] is to the contrary. The New York doctrine has recently received the emphatic approval of the Supreme Court.[25]

§ 213. Its application to creditors' rights and its origin.

But as against creditors of the corporation, the rule is quite different. If the company should become insolvent all unpaid stock subscriptions may be enforced by those who became creditors subsequently

[22] *Blum* v. *Whitney*, 185 N. Y. 232; *Christensen* v. *Eno*, 106 N. Y. 97.

[23] *Erlanger* v. *New Sombrero Phosphate Co.*, L. R., 3 A. C. 1218.

[24] *Old Dominion Copper Co.* v. *Bigelow*, 188 Mass. 315.

[25] *Old Dominion Copper Co.* v. *Lewisohn*, 210 U. S. 206, 28 Sup. Ct. Rep. 634.

to the date of the subscriptions. This doctrine was first established by Mr. Justice Story, in *Wood* v. *Dummer*.[26]

§ 214. Its rationale.

The learned justice worked out the theory on the idea of a trust fund. It must be remembered that he was then establishing a new rule of equity, and the case but illustrates again what Jessel, M. R., has styled "the gradual refinement of the doctrines of equity."[27] Mr. Justice Story, however, desired to seek safety for this theory in some established category, and so he declared that the capital stock of a corporation is a trust fund for creditors, and, therefore, may be traced like any other trust fund. But the decision actually rested on the common experience of reasonable men. Accordingly, we find the justice saying that "credit is universally given to this fund by the public as the only means of redemption."

§ 215. Later cases.

This case was later approved by the Supreme Court in *Ogilvie* v. *Knox Ins. Co.*,[28] where again we find the basis of the rule stated by Mr. Justice Grier, that the capital is "a fund publicly pledged." The rule again was applied in *Sawyer* v. *Hoag*,[29] and Mr. Justice Miller, who delivered the opinion of the court, considered that such a transaction "was a fraud upon the public who were expected to deal with them." The rule was subsequently discussed in many decisions by the Supreme Court, the later of which are

[26] 3 Mason, 308, Fed. Cas. No. 17,944.
[27] *In re Hallett's Estate*, L. R., 13 Ch. D. 696.
[28] 22 How. 380.
[29] 17 Wall. 610.

stated in *McDonald* v. *Williams*.[30] The court did not ask for actual proof of fraud or actual deceit practiced upon the particular plaintiff. It laid down a general doctrine based on the experience of mankind, and, as stated by Mr. Justice Miller in *Sawyer* v. *Hoag*,[31] "the necessity of adapting legal practice to the new and varying exigencies of this business."

§ 216. It rests on the presumption of reliance.

It is then a presumption that the rule rests on, and the fraud dealt with is so styled. It is not for the complainant to show more than the facts creating a case which deserves such characterization. He need not show individual reliance upon the pretended facts held out to the public, but it is for the defendant to show that the question is academic in the particular case because nobody was hurt. This is well brought out in *Hospes* v. *The Northwestern Car Co.*[32] The court there discussed the precise point:

> "It is urged, however, that if fraud be the basis of the stockholders' liability in such cases, the creditor should affirmatively allege that he believed that the bonus stock had been paid for, and represented so much actual capital, and that he gave credit to the corporation on the faith of it; and it is also argued, that while there may be a presumption to that effect in the case of a subsequent creditor, this is a mere presumption of fact, and that in pleadings no presumptions of fact are indulged in. This position is very plausible, and at first sight would seem to

[30] 174 U. S. 397, 19 Sup. Ct. Rep. 743.
[31] *Supra.*
[32] 48 Minn. Rep. 174.

have much force, but we think it is unsound. Certainly any such rule of pleading or proof would work very inequitably in practice. Inasmuch as the capital of a corporation is the basis of its credit, its financial standing and reputation in the community has its source in, and is founded upon, the amount of its professed and supposed capital, and every one who deals with it does so upon the faith of that standing and reputation, although, as a matter of fact, he may have no personal knowledge of the amount of its professed capital, and in a majority of cases knows nothing about the shares of stock held by any particular stockholder, or, if so, what was paid for them. Hence, in a suit by such creditor against the holders of "bonus" stock, he could not truthfully allege, and could not affirmatively prove, that he believed that the defendants' stock had been paid for, and that he gave the corporation credit on the faith of it, although, as a matter of fact, he actually gave the credit on the faith of the financial standing of the corporation, which was based upon its apparent and professed amount of capital. The misrepresentation as to the amount of capital would operate as a fraud on such a creditor as fully and effectually as if he had personal knowledge of the existence of the defendants' stock, and believed it to have been paid for when he gave the credit. For this reason, among others, we think that all that it is necessary to allege or prove in that regard is that the plaintiff is a subsequent creditor; and that, if the fact was that he dealt with the corporation with knowledge of the arrangement by which the "bonus" stock was issued, this is a matter of defense."

§ 217. **Hence applies only in case of insolvency.**

Therefore here, as in other cases of reputed ownership, it is for the defendant to show that some other facts are present in the case which renders it academic in the particular instance. That is what the Supreme Court means in *McDonald* v. *Williams*,[33] where it states the well-known limitation of the trust fund doctrine, viz., that it does not apply in the case of a solvent corporation. Of course it does not apply in such a case because then the question is academic.

[33] 174 U. S. 397, 19 Sup. Ct. Rep. 743.

THE STATUTE OF JAMES.

[A. D. 1623. 21st Year of James I.]

Ch. XIX.

"AN ACT for the further Description of a Bankrupt, and Relief of Creditors against such as shall become Bankrupts, and for inflicting corporal Punishment upon the Bankrupts in some special cases."

I. Forasmuch as daily experience sheweth, that the Number and Multitude of Bankrupts do increase more and more, and also the Frauds and Deceits invented and practised for the avoiding and deluding the Penalties of the good Laws in that Behalf already made, and the Remedy by them provided; (2) and for that divers Defects are daily found in the former Statutes made against Bankrupts, both in the Description of Bankrupt, as also in the Power given to the Commissioners for the Discovery and distribution of the Bankrupt's Estate, to the great Encouragement of evil-minded Persons, the Hindrance of Traffick and Commerce, the great Decay, Overthrow and Undoing of many Clothiers, by whom many Thousands of natural born Subjects of this Realm be from Time to Time in all Parts of this Kingdom set on work; all which do tend to the general Hurt of this Realm: (3) For Remedy whereof, be it enacted by the King's most excellent Majesty, the Lord's Spiritual and Temporal, and Commons in this present Parliament assembled, and by the Authority of the same, That all and singular the aforesaid Statutes and Laws heretofore made against Bankrupts, and for the Relief of

Creditors shall be in all Things largely and beneficially construed and expounded for the Aid, Help and Relief of the Creditors of such Person or Persons as already be or hereafter shall become bankrupt;

* * * * * * * * *

X. And be it further enacted, That if it shall happen, any the Lands, Tenements, Goods, Chattels, Debts or other Estate of any Bankrupt, to be extended after such Time as he or she is become a Bankrupt, by any Person or Persons, under Colour or Pretense of his or their being an Accountant, or any way indebted unto our Sovereign Lord the King's Majesty, his Heirs or Successors, that then it shall be lawful to and for the said Commissioners to examine upon Oath, whether the said Debt were due to such Debtor or Accountant, upon any Bargain or Contract originally made betwixt such Accountant and the said Bankrupt, the said Debtor or Accountant and his or their Servants: (2) And if such Bargain or Contract was originally made to and with any other Person or Persons than the said Debtor or Accountant, or for the Use and Trust of any other Person or Persons, then it shall and may be lawful to and for the said Commissioners or the greater Part of them, to order and dispose of all such Lands, Tenements, Hereditaments, Goods, Chattels and Debts, so extended as aforesaid, to and for the Use of the Creditors which shall seek Relief by the said Commission; (3) and that the Order and Disposition of the said Commissioners or the greater Part of them shall be good and available against the said Extent, and against all Persons claiming from, by or under the said Extent; (4) and such Person or Persons to whom the said Lands, Tenements, Goods and Chattels so extended,

shall be bargained, sold, granted, or assigned by the Commissioners aforesaid or the greater Part of them, shall have good remedy to have, demand and recover the same against such Person and Persons who shall detain the same; (5) 'And for that it often falls out, that many Persons before they become Bankrupts, do convey their Goods to other Men upon good consideration, yet still keep the same, and are reputed the Owners thereof, and dispose the same as their own;'

XI. Be it enacted, That if at any Time hereafter any Person or Persons shall become Bankrupt, and at such time as they shall so become Bankrupt shall by the Consent and Permission of the true Owner and Proprietary have in their Possession, Order and Disposition, any Goods or Chattels, whereof they shall be reputed Owners, and take upon them the Sale, Alteration or Disposition as Owners, that in every such case the said Commissioners or the greater Part of them shall have Power to sell and dispose the same, to and for the Benefit of the Creditors which shall seek Relief by the said Commission, as fully as any other Part of the Estate of the Bankrupt; (2) And for the better Payment of Debts and discouraging Men to become Bankrupts."

REPUTED OWNERSHIP CLAUSE OF PRESENT ENGLISH BANKRUPTCY ACT.

[Eng. Bankruptcy Act of 1883, § 44.]

"The property of the bankrupt divisible amongst his creditors, and in this act referred to as the property of the bankrupt, shall comprise of the following particulars:

* * * * * * * * *

III. All goods being, at the commencement of the bankruptcy, in the possession, order or disposition of the bankrupt, in his trade or business, by the consent and permission of the true owner, under such circumstances that he is the reputed owner thereof; provided that things in action other than debts due or growing due to the bankrupt in the course of his trade or business, shall not be deemed goods within the meaning of this section."

STATUTE OF FRAUDULENT CONVEYANCES.

[Statute of 13 Eliz., Ch. V.]

AN ACT against Fraudulent Deeds, Alienations, etc.

"For the avoiding and abolishing of feigned, covenous and fraudulent feoffments, gifts, grants, alienations, conveyances, bonds, suits, judgments, and executions, as well of lands and tenements as of goods and chattels, more commonly used and practised in these days than hath been seen or heard of heretofore; which feoffments, gifts, grants, alienations, conveyances, bonds, suits, judgments, and executions have been and are devised and contrived of malice, fraud, covin, collusion, or guile, to the end, purpose, and intent to delay, hinder or defraud creditors and others of their just and lawful actions, suits, debts, accounts, damages, penalties, forfeitures, heriots, mortuaries, and reliefs, not only to the let or hindrance of the due course and execution of law and justice, but also to the overthrow of all true and plain dealing, bargaining, and chevisance between man and man, without the which no commonwealth or civil society can be maintained or continued;

"II. It is therefore declared, ordained, and enacted, that all and every feoffment, gift, grant, alienation,

bargain, and conveyance of lands, tenements, hereditaments, goods, and chattels, or of any of them, or of any lease, rent, common, or other profit or charge out of the same lands, tenements, hereditaments, goods, and chattels, or any of them, by writing or otherwise, and all and every bond, suit, judgment, and execution at any time had or made sithence the beginning of the queen's majesty's reign that now is, or at any time hereafter to be made to or for any intent or purpose before declared and expressed, shall be from henceforth deemed and taken (only as against that person or persons, his or their heirs, successors, executors, administrators, and assigns, and every of them, whose actions, suits, debts, accounts, damages, penalties, forfeitures, heriots, mortuaries, and reliefs, by such guileful, covinous, or fraudulent devices and practices, as is aforesaid, are, shall or might be in anywise disturbed, hindered, delayed, or defrauded) to be clearly and utterly void, frustrate, and of none effect; any pretence, colour, fained consideration, expressing of use, or any other matter or thing to the contrary notwithstanding."

"V. Provided that this act, or anything therein contained, shall not extend to any estate or interest in lands, tenements, hereditaments, leases, rents, commons, profits, goods, or chattels, had, made, conveyed, or assured, or hereafter to be had, made, conveyed, or assured, which estate or interest is or shall be upon good consideration and *bona fide* lawfully conveyed or assured to any person or persons, or bodies politic or corporate, not having at the time of such conveyance, or assurance to them made, any manner of notice or knowledge of such covin, fraud, or colusion, as is aforesaid."

NEW YORK STATUTES AS TO CONVEYANCES IN FRAUD OF CREDITORS.

[Consolidated Laws of 1909, Title, Personal Property Law, Vol. 4, p. 4203.]

" § 35. **Transfers and charges with fraudulent intent.**—Every transfer of any interest in personal property; or the income thereof, and every charge on such property or income, made with the intent to hinder, delay or defraud creditors or other persons of their lawful suits, damages, forfeitures, debts or demands, and every bond or other evidence of debt given, suit commenced, or decree or judgment suffered, with such intent, is void as against every person so hindered, delayed or defrauded."

And Title, Real Property Law, Vol. 4, p. 5077, Consolidated Laws of New York, 1909:

" § 263. **Conveyances with intent to defraud creditors void.**— A conveyance or assignment in writing or otherwise, of an estate, interest, or existing trust in real property, or the rents or profits issuing therefrom, or a charge on real property, or on the rents or profits thereof, made with the intent to hinder, delay or defraud creditors, or other persons, of their lawful suits, damages, forfeiture, debts or demands, or a bond or other evidence of debt given, suits commenced or decree or judgment suffered, with the like intent, is void as against every person so hindered, delayed or defrauded."

PROVISIONS OF THE NATIONAL BANKRUPTCY ACT OF 1898, AFFECTING THE SUBJECT DISCUSSED:

" § 70. **Title to property.**—**a.** The trustee of the estate of a bankrupt, upon his appointment and qualification,

and his successor or successors, if he shall have one or more, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt, as of the date he was adjudged a bankrupt, except in so far as it is to property which is exempt to all; * * * (5) property which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him: *Provided,* That when any bankrupt shall have any insurance policy which has a cash surrender value payable to himself, his estate, or personal representatives, he may, within thirty days after the cash surrender value has been ascertained and stated to the trustee by the company issuing the same, pay or secure to the trustee the sum so ascertained and stated, and continue to hold, own, and carry such policy free from the claims of the creditors participating in the distribution of his estate under the bankrupt proceedings, otherwise the policy shall pass to the trustee as assets."

" § 67. **Liens.**—a. Claims which for want of record or for other reasons would not have been valid liens as against the claims of the creditors of the bankrupt shall not be liens against his estate."

SALES IN BULK ACT.

[Personal Property Law of New York, Laws of 1909, Chapter 45, Section 44.]

" § 44. **Transfer of goods in bulk.**—1. The transfer of any portion of a stock of goods, wares or merchandise otherwise than in the ordinary course of trade, in the regular and usual prosecution of the transferrer's business, or the transfer of an entire

such stock in bulk, shall be presumed to be fraudulent and void as against the creditors of the transferrer, unless the proposed transferee shall, at least five days before the transfer, in good faith, make full and explicit inquiry of the transferrer as to the names and addresses of each and all of the creditors of the transferrer, and unless such transferee shall at least five days before the transfer in good faith notify or cause to be notified of the proposed transfer personally or by registered mail each of the creditors of the transferrer of whom such transferee has knowledge, or can with the exercise of reasonable diligence acquire knowledge.

2. The transferrer shall at least five days before such transfer fully and truthfully answer in writing such transferee's inquiries as to the names and addresses of the transferrer's creditors, and if such transferrer shall knowingly or willfully refuse so to answer or make or deliver or cause to be made or delivered to such tranferee any false or incomplete answer to such inquiries, said transferrer shall be deemed guilty of a misdemeanor, and upon conviction thereof shall be punished accordingly.

3. Transfers under this section shall include sales, exchanges and assignments, but nothing contained in this section shall apply to transfers by executors, administrators, receivers, assignees under a voluntary assignment for the benefit of creditors, trustee in bankruptcy, or by any public officer under judicial process."

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